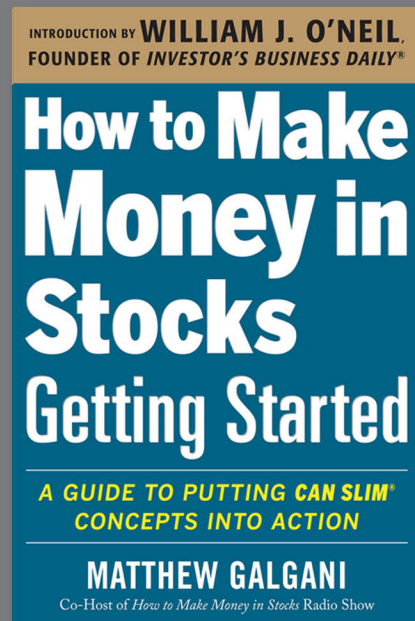
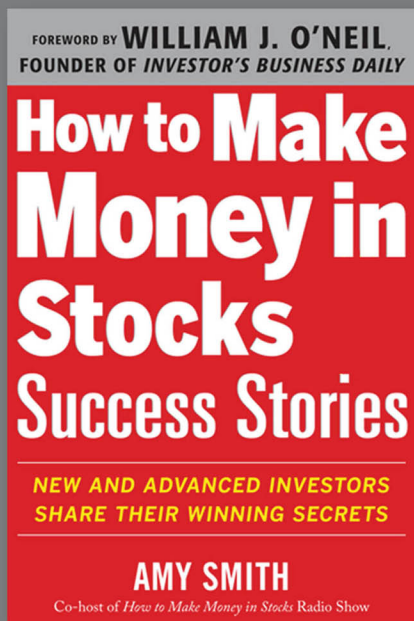
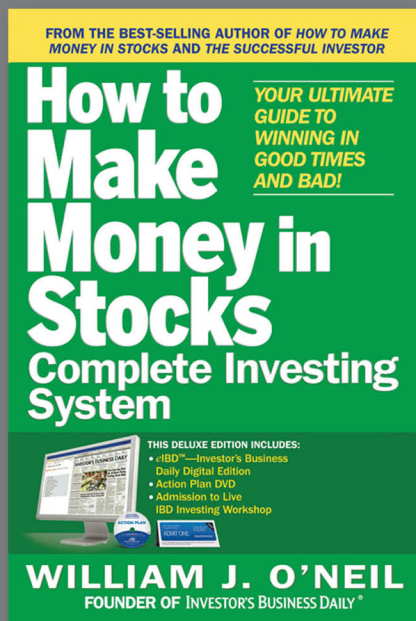


HOW TO MAKE MONEY IN STOCKS TRILOGY



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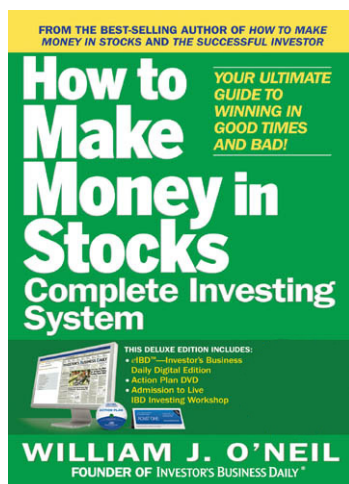
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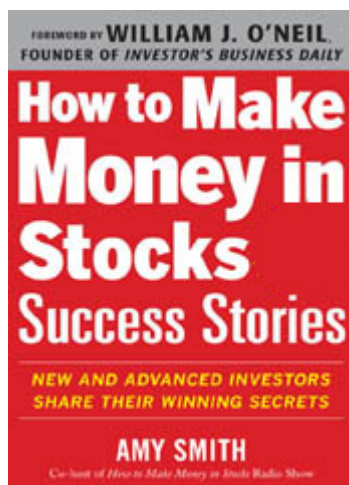
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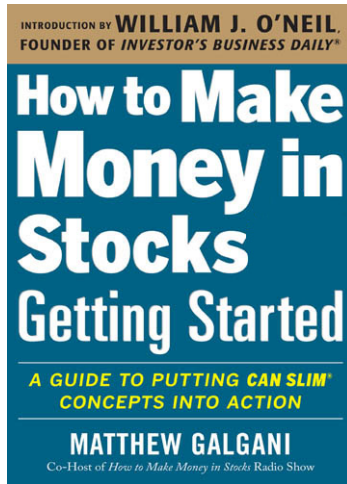
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WILLIAM J. O'NEIL
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How to Make Money in Stocks

**COMPLETE
INVESTING SYSTEM**

WILLIAM J. O'NEIL



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• PART •

**A Winning
System:
CAN SLIM®**

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You Must Learn and Benefit from America's 100 Years of Super Winners

After the market debacles of 2000 and 2008, investors now realize they must take charge and learn much more about what they're doing when they save and invest their hard-earned money. However, many investors don't know where to turn, whom to trust, or what they must stop doing in order to achieve true superior investment performance.

You don't have to give your money to a Bernie Madoff, who'll take it but won't tell you exactly what he's doing with it. Instead, you need to read a few of the best investment books, attend some investment classes, or participate in an investment meet-up group so you can learn how to invest with real knowledge and confidence. At the very least, you need to learn and understand well the sound principles, proven rules and methods that can protect and build your investment portfolio over time. Half of all Americans save and invest; now it's time to learn to do it intelligently with critical know-how.

When I started investing, I made most of the same mistakes you've probably made. But here's what I've learned:

- You buy stocks when they're on the way up in price, not on the way down. And when you buy more, you do it *only* after the stock has risen from your purchase price, not after it has fallen below it.
- You buy stocks when they're nearer to their highs for the year, not when they've sunk lower and look cheap. You buy higher-priced, better quality stocks rather than the lowest-priced stocks.

- You learn to always sell stocks quickly when you have a small 7 or 8% loss rather than waiting and hoping they'll come back. Many don't.
- You pay far less attention to a company's book value, dividends, or PE ratio—which for the last 100 years have had little predictive value in spotting America's most successful companies—and focus instead on vital historically proven factors such as strong earnings and sales growth, price and volume action, and whether the company is the number one profit leader in its field with a superior new product.
- You don't subscribe to a bunch of market newsletters or advisory services, and you don't let yourself be influenced by recommendations from analysts, or friends who, after all, are just expressing personal opinions that can frequently be wrong and prove costly.
- You also must acquaint yourself with daily, weekly, and monthly price and volume charts—an invaluable tool the best professionals wouldn't do without but amateurs tend to dismiss as irrelevant.
- Lastly, you must use time-tested sell rules to tell you when to sell a stock and take your worthwhile gains. Plus you'll need buy and sell rules for when it's best to enter the general market or sell and lower your percent invested. Ninety percent of investors have neither of these essential elements.

All these wise actions are totally contrary to human nature! In reality, the stock market is human nature and crowd psychology on daily display, plus the age-old law of supply and demand at work. Because these two factors remain the same over time, it is remarkable but true that chart patterns are just the same today as they were 50 years ago or 100 years ago. Few investors know or understand this. It can be your priceless advantage.

In this fourth edition of *How to Make Money in Stocks*, I'm showing you right up front, in Chapter 1, 100 annotated color charts of 100 of America's greatest winning stocks, covering each decade from the 1880s to the end of 2008—from the Richmond and Danville Railroad in 1885 and Northern Pacific during the famous corner of the stock in 1901, when it raced from \$115 to \$700 in one week, to Apple and Google in our twenty-first century.

There is an enormous amount you will learn from studying these great historical examples. You'll see chart base patterns that are repeated year after year with huge success. There are 105 examples (among the 100 stocks) of classic chart bases that look like cups with handles. Some are small cups, others large, and others in between.

In addition to cups with handles, we've identified eight other distinctively different, highly successful chart base patterns that occurred in cycle after cycle. Bethlehem Steel in 1915 is our first powerful high, tight flag example and served as a perfect historical precedent for later high, tight flag patterns

such as Syntex, Rollins, Simmonds Precision, Yahoo!, and Taser. All of these stocks had spellbinding price moves.

Charts plus earnings will help you tell the best stocks and general markets from the weaker, riskier stocks and markets that you must avoid altogether. That's why I put all these outstanding chart examples in Chapter 1, with notes marked on each chart to help you learn a skill that could just change your whole life and let you live better and far smarter.

A good clear picture is worth a thousand words. These 100 examples are just a small sample of what you've been missing for years. We have models of more than 1,000 great stock market winners over the last 100 years. It takes only one or two to make your year or your future. But you have to get serious and work at really learning and knowing what you're doing when you invest. You can do it if you really want to and it's important to you.

You'll find this an exciting "common sense" new way of viewing America and its stock market. From the railroad to the auto and the airplane, from the radio and TV to computers, from jet airliners to space exploration, from massive discount stores to semiconductors and the Internet, this country has shown rapid, unceasing growth. Living standards for the great majority of Americans have improved materially from 100, 50, or even 30 years ago.

Yes, there will always be problems, and everyone likes to criticize. But America's innovators, entrepreneurs, and inventors have been a major driving force behind its unparalleled growth. They have created the new industries, new technologies, new products, new services, and 80% of the jobs from which we all continually benefit.

Now it's up to you to learn how to intelligently take advantage of the relentless growth opportunities America's freedom makes possible and that entrepreneurs keep presenting for you during every business cycle.

In the following chapters, you will learn how to pick big winners in the stock market and nail down the gains they produce. You will also learn how to substantially reduce your mistakes and losses.

Many people who dabble in stocks either have mediocre results or lose money because of their lack of knowledge. But no one has to continue to lose money. You can definitely learn to invest wisely. This book will provide you with the investment understanding, skills, and methods you need to become a more successful investor, if you're willing to work at it.

I believe most people in this country and throughout the free world, whether young or old, regardless of their profession, education, background, or economic position, should learn to save and invest in common stocks. This book isn't written for the elite, but for the millions of ordinary individuals everywhere who want a chance to be better off financially. You are never too old or too young to start investing intelligently.

- **YOU CAN START SMALL**—If you're a typical working person or a beginning investor, you should know that it doesn't take a lot of money to start. You can begin with as little as \$500 to \$1,000 and add to it as you earn and save more money. I began with the purchase of just five shares of Procter & Gamble when I was only 21 and fresh out of school.

Mike Webster is one of our in-house managers who also started small. In fact, Mike sold personal belongings, including his music CD collection, to raise cash for investing. Prior to managing money for the firm, he had a gain of over 1,000% in his personal account in 1999, a very unusual year.

Steve Birch, another of our in-house money managers, started managing money earlier. He took advantage of the roaring bull market of the late 1990s and protected most of his gains by going mainly to cash in the bear market. Between 1998 and 2003, he had gained over 1,300%. Both Mike and Steve have had their rough years, but they've learned from their many mistakes, which we all make, and have gone on to achieve significant performance.

You live in a fantastic time of unlimited opportunity, an era of outstanding new ideas, emerging industries, and new frontiers. However, you have to read the rest of this book (probably two or three times) to learn how to recognize and take full advantage of these amazing new situations.

Opportunities are there for everyone. You are in a continually changing and, hopefully, improving New America. We lead the world in high technology, the Internet, medical advancements, computer software, military capability, and innovative new entrepreneurial companies. The communist/socialist system of a centralized "command economy" disintegrated on the ash heap of history. It did not work. Stalin's old Soviet Union killed 20 million of its own people. Our system of freedom and opportunity serves as a model of success for most countries in the world.

Today it's not enough for you to just work and earn a salary. To do the things you want to do, go where you want to go, and have the things you want to have in your life, you must save and invest intelligently. The income from your investments and net gains you can make will, in time, let you reach your goals and provide you real security. This book can change your whole life. No one can hold you back but yourself. Think positive.

- **SECRET TIP**—The first step in learning how to pick big stock market winners is to examine leaders of the past, like those you're about to see, to learn all the characteristics of the most successful stocks. From these observations, you will be able to recognize the types of price and earnings patterns these stocks developed just before their spectacular price advances.

Key factors you'll discover include what the quarterly earnings of these companies were at the time, what the annual earnings histories of these organizations had been in the prior three years, what amount of trading volume was present, what degree of relative strength there was in the prices of the stocks before their enormous success, and how many shares of common stock were outstanding in the capitalization of each company.

You'll also learn many of the greatest winners had significant new products or new management, and many were tied to strong industry group moves caused by important changes occurring in an entire industry.

It's easy to conduct this type of practical, commonsense analysis of all past successful leaders. I have already completed such a comprehensive study. In our historical analysis, we selected the greatest winning stocks in the stock market each year (in terms of percentage increase for the year), spanning the past 125 years.

We call the study "The Model Book of Greatest Stock Market Winners." It's been expanded recently to cover stocks dating back to the 1880s. It now analyzes more than 1,000 of the biggest winning companies in recent market history in detail, super stocks such as

Texas Instruments, whose price soared from \$25 to \$250 from January 1958 through May 1960

Xerox, which escalated from \$160 to the equivalent of \$1,340 between March 1963 and June 1966

Syntex, which leaped from \$100 to \$570 in only six months during the last half of 1963

Dome Petroleum and Prime Computer, which advanced 1,000% and 1,595%, respectively, in the 1978–1980 stock market

Limited Stores, which wildly excited lucky shareowners with a 3,500% increase between 1982 and 1987

Cisco Systems, which between October 1990 and March 2000 advanced from a split-adjusted \$0.10 to \$82

Home Depot and Microsoft both increased more than 20 times during the 1980s and early 1990s. Home Depot was one of the all-time great performers, jumping 20-fold in less than two years from its initial public offering in September 1981 and then climbing another 10 times from 1988 to 1992. All of these companies offered exciting new entrepreneurial products and concepts. In total, we actually have 10 different model books that cover America's innovative and highly successful companies.

Would you like to know the common characteristics and rules of success we discovered from this intensive study of all past stock market leaders?

They're all covered in the next few chapters and in a simple, easy-to-remember formula we have named CAN SLIM. Each letter in the words CAN SLIM stands for one of the seven chief characteristics of these greatest winning stocks at their early developing stages, just before they made huge profits for their shareholders and our country (companies and employees all pay taxes as well as helping to improve our standard of living). Write this formula down, and repeat it several times so you won't forget it.

The reason CAN SLIM continues to work cycle after cycle and AAI's 11-year independent study, done in real time, rated it the top investment strategy in America is it's based 100% on realistic historical studies of how the stock market has actually worked rather than on our personal opinion or anyone else's, including Wall Street's . . . or academic theorists'. Furthermore, human nature at work in the market simply doesn't change. So CAN SLIM does not get outmoded as fads, fashions, and economic cycles come and go. It will beat big egos, personal opinions, and emotions every time.

You can definitely learn how to pick winners in the stock market, and you can become part owner of the best companies in the world. So, let's get started right now. Here's a sneak preview of CAN SLIM:

- C** Current Quarterly Earnings and Sales: *The Higher, the Better*
- A** Annual Earnings Increases: *Look for Significant Growth*
- N** New Products, New Management, New Highs: *Buying at the Right Time*
- S** Supply and Demand: *Shares Outstanding Plus Big Volume Demand*
- L** Leader or Laggard: *Which Is Your Stock?*
- I** Institutional Sponsorship: *Follow the Leaders*
- M** Market Direction: *How You Can Learn to Determine It*

Please begin immediately with Chapter 1. Go for it. You can do it.

1

• CHAPTER •

America's Greatest Stock-Picking Secrets

In this latest revised edition, you'll observe 100 charts of the greatest winners from 1880 to 2009. Study them carefully. You'll discover secret insights into how these companies set the stage for their spectacular price increases.

Don't worry if you're a new investor and don't understand these charts at first. After all, every successful investor was a beginner at some point—and this book will show you how to spot key buying opportunities on the charts, as well as critical signals that a stock should be sold. To succeed you need to learn sound, historically proven buy rules plus sell rules.

As you study these charts you'll see there are specific chart patterns that are repeated over and over again whether in 1900 or 2000. This will give you a huge advantage once you learn to, with practice, recognize these patterns that in effect tell you when a stock is under professional accumulation.

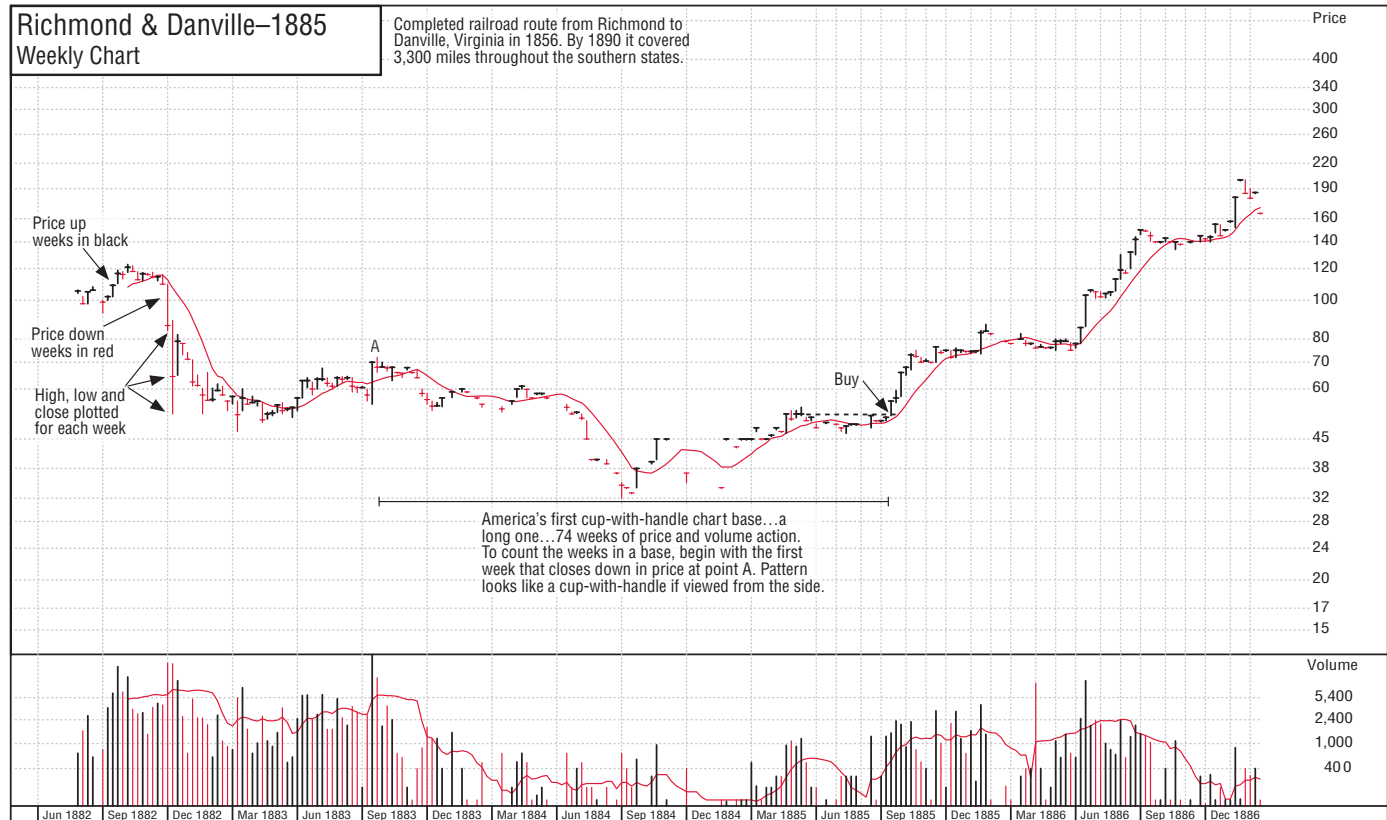
It is the unique combination of your finding stocks with big increases in sales, earnings and return on equity plus strong chart patterns revealing institutional buying that together will materially improve your stock selection and timing. The best professionals use charts.

You too can learn this valuable skill.

This book is all about how America grows and you can too. The American dream can be yours if you have the drive and desire and make up your mind to never give up on yourself or America.

Richmond & Danville–1885 Weekly Chart

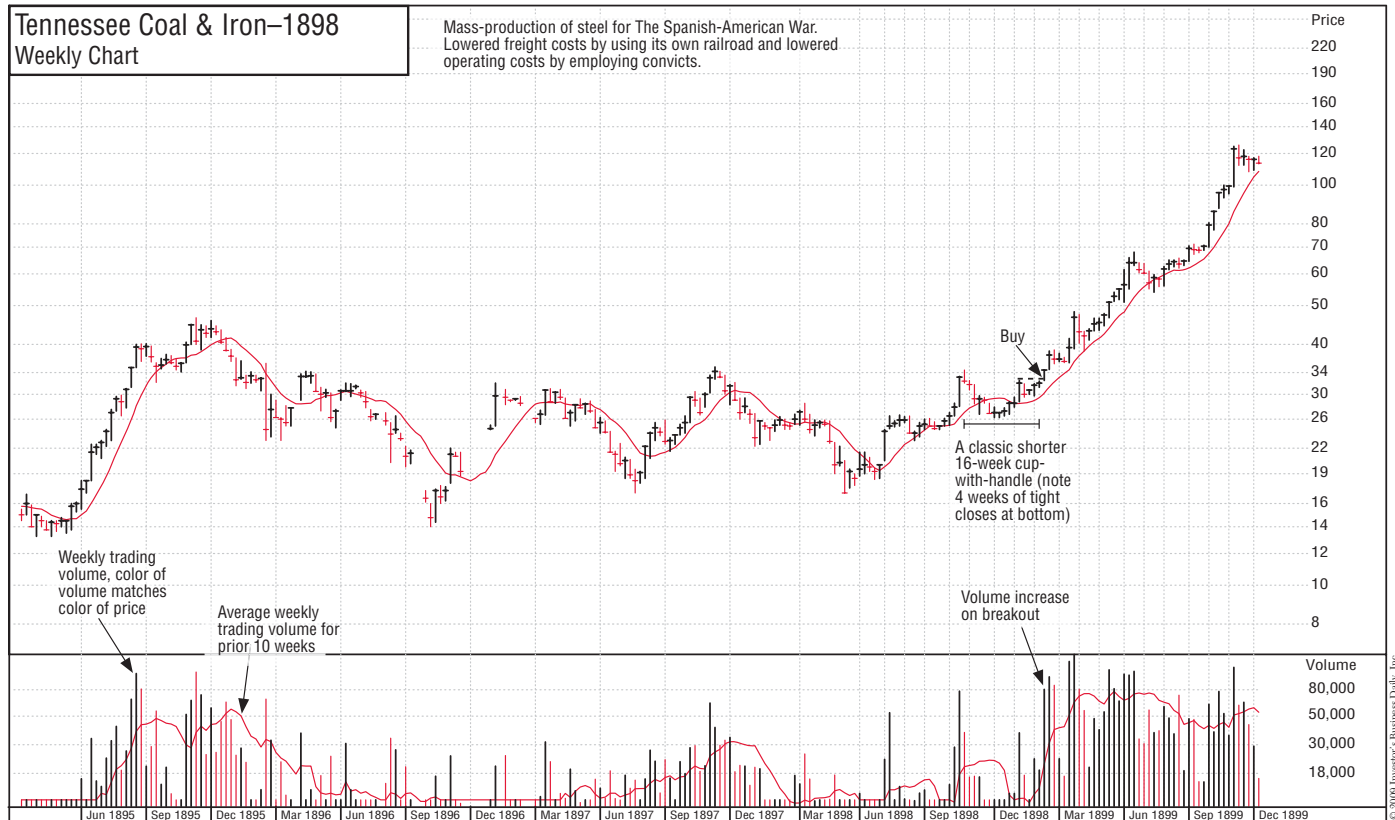
Completed railroad route from Richmond to Danville, Virginia in 1856. By 1890 it covered 3,300 miles throughout the southern states.



Richmond & Danville increased 257% in 70 weeks.

Tennessee Coal & Iron-1898 Weekly Chart

Mass-production of steel for The Spanish-American War.
Lowered freight costs by using its own railroad and lowered
operating costs by employing convicts.



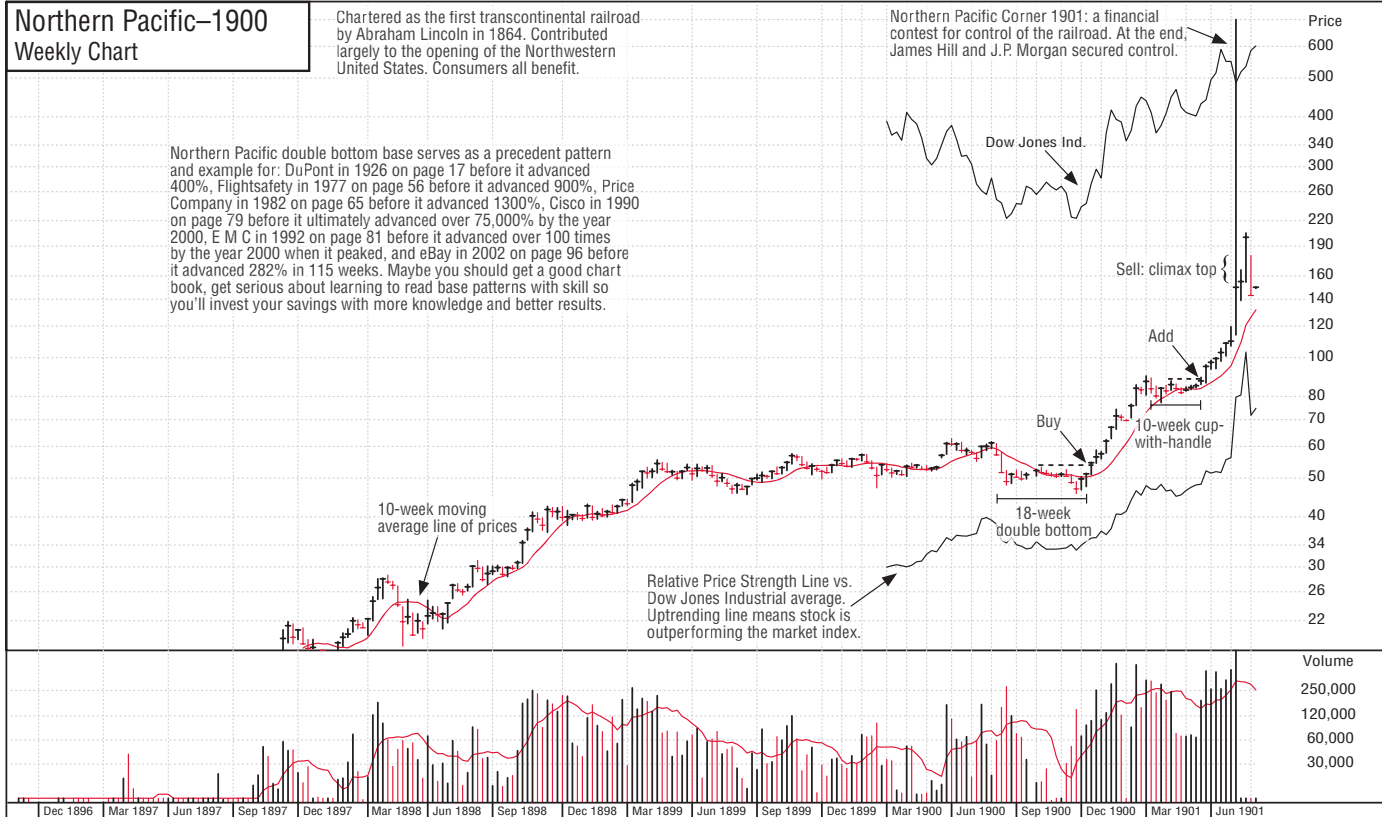
Tennessee Coal & Iron increased 265% in 39 weeks.

Northern Pacific-1900 Weekly Chart

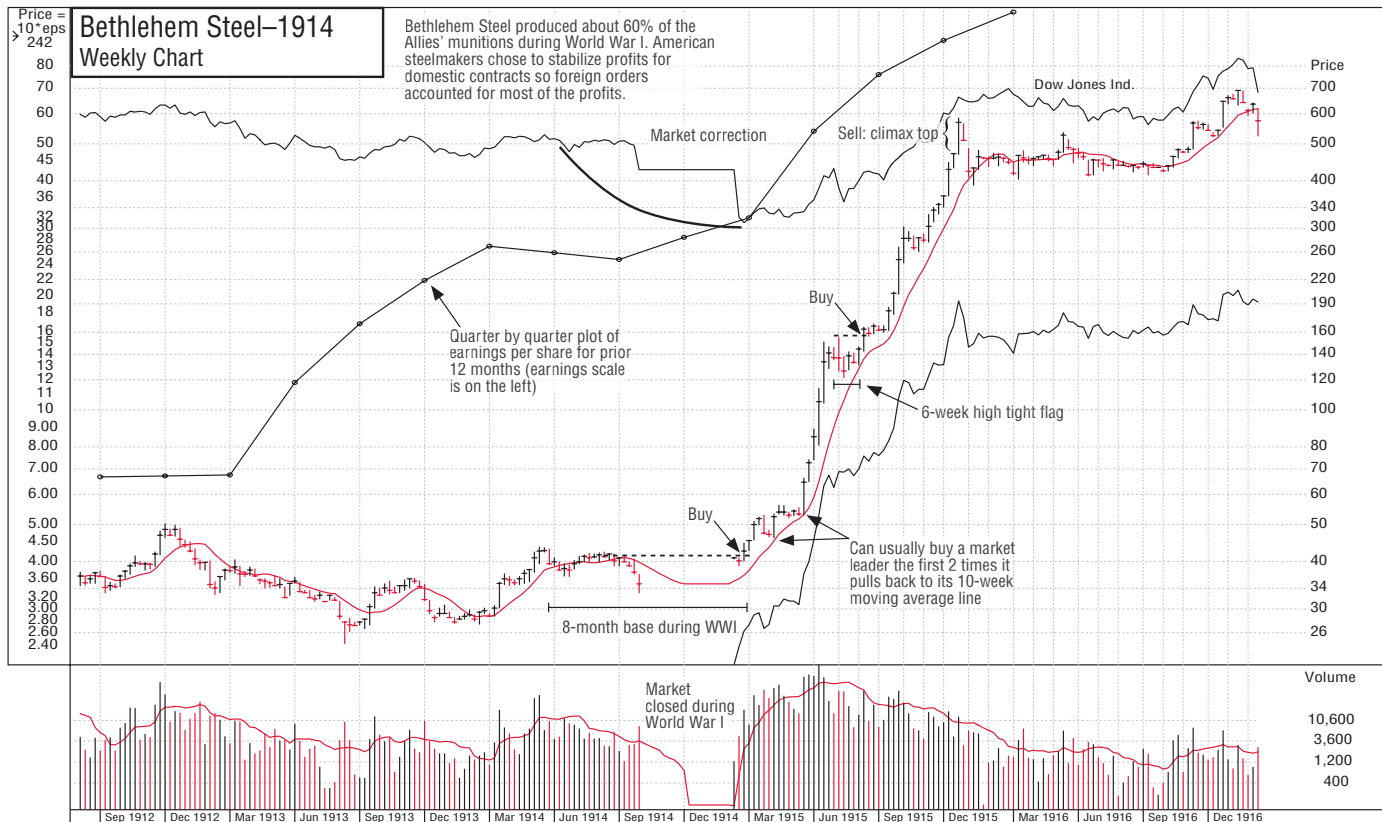
Chartered as the first transcontinental railroad by Abraham Lincoln in 1864. Contributed largely to the opening of the Northwestern United States. Consumers all benefit.

Northern Pacific double bottom base serves as a precedent pattern and example for: DuPont in 1926 on page 17 before it advanced 400%, Flightsafety in 1977 on page 56 before it advanced 900%, Price Company in 1982 on page 65 before it advanced 1300%, Cisco in 1990 on page 79 before it ultimately advanced over 75,000% by the year 2000, E M C in 1992 on page 81 before it advanced over 100 times by the year 2000 when it peaked, and eBay in 2002 on page 96 before it advanced 282% in 115 weeks. Maybe you should get a good chart book, get serious about learning to read base patterns with skill so you'll invest your savings with more knowledge and better results.

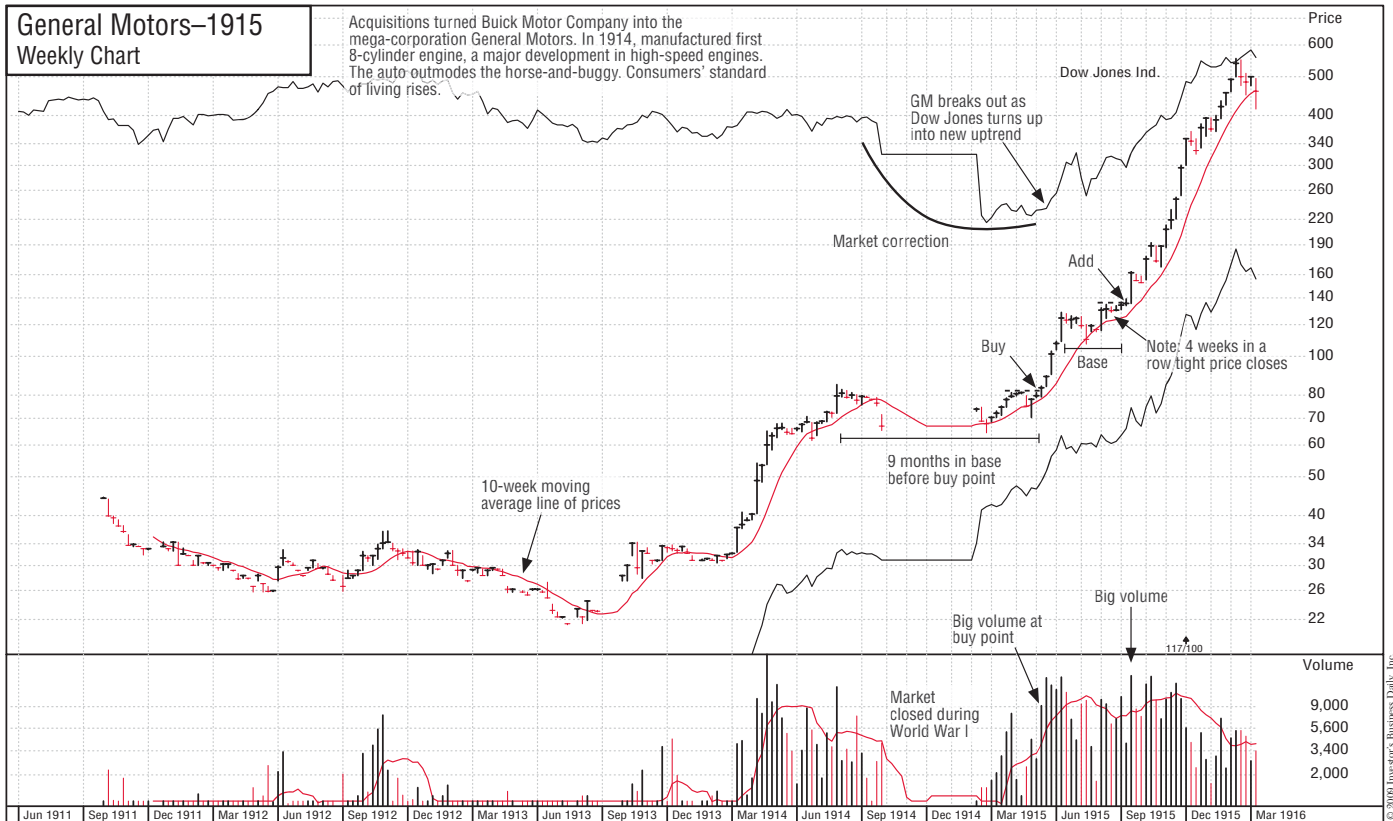
Northern Pacific Corner 1901: a financial contest for control of the railroad. At the end, James Hill and J.P. Morgan secured control.



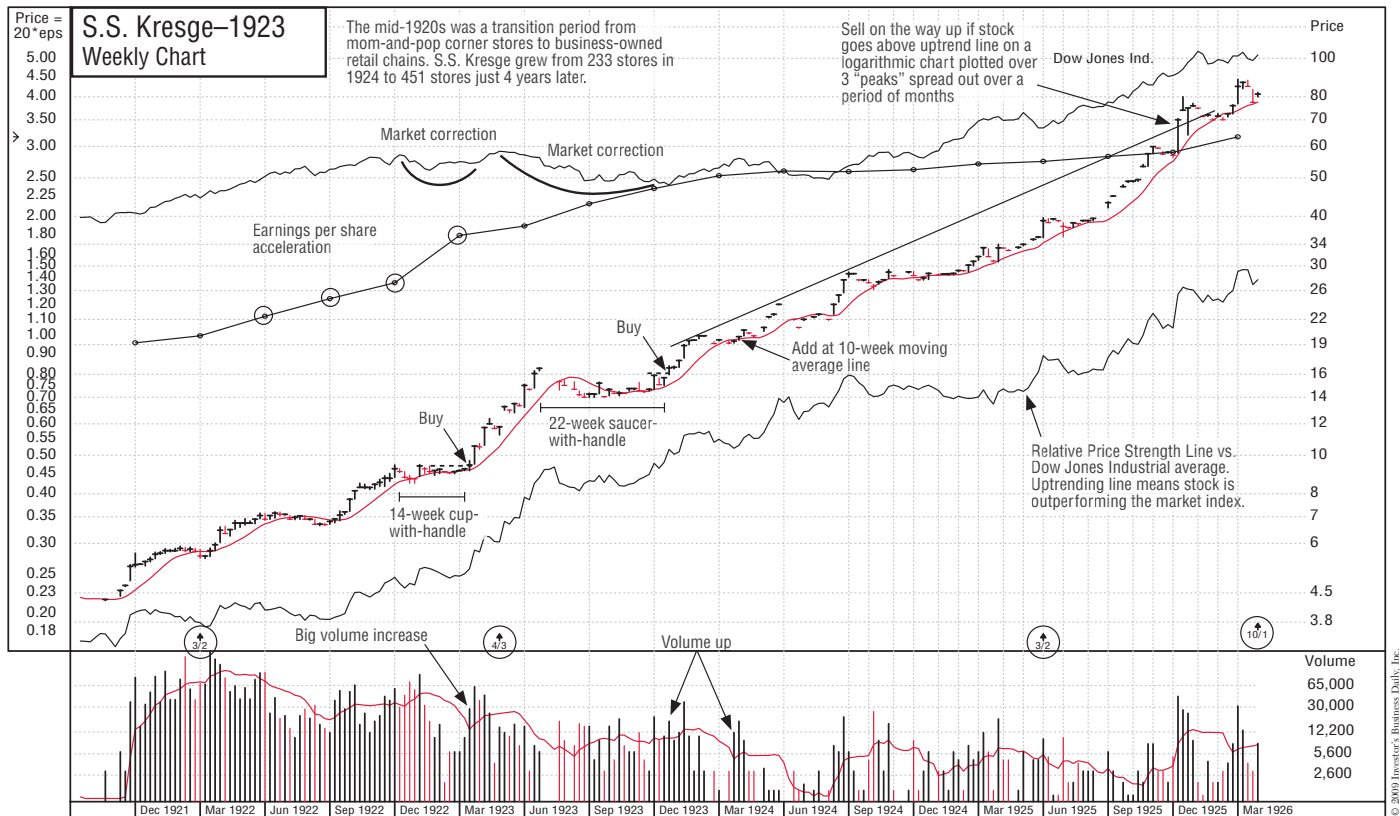
Northern Pacific increased 1181% in 29 weeks.



Bethlehem Steel increased 1479% in 99 weeks.



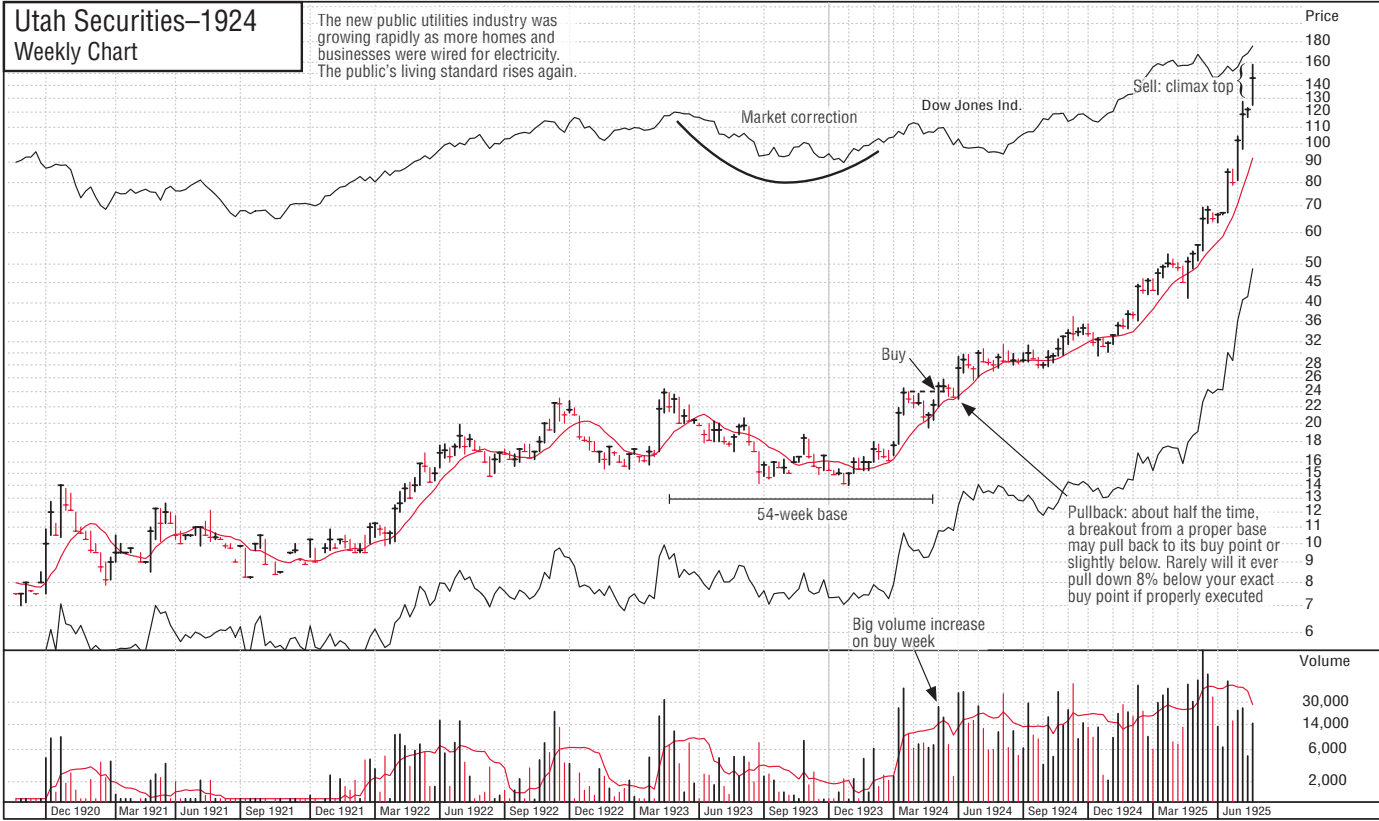
General Motors increased 471% in 39 weeks.



S.S. Kresge increased 836% in 154 weeks.

Utah Securities-1924 Weekly Chart

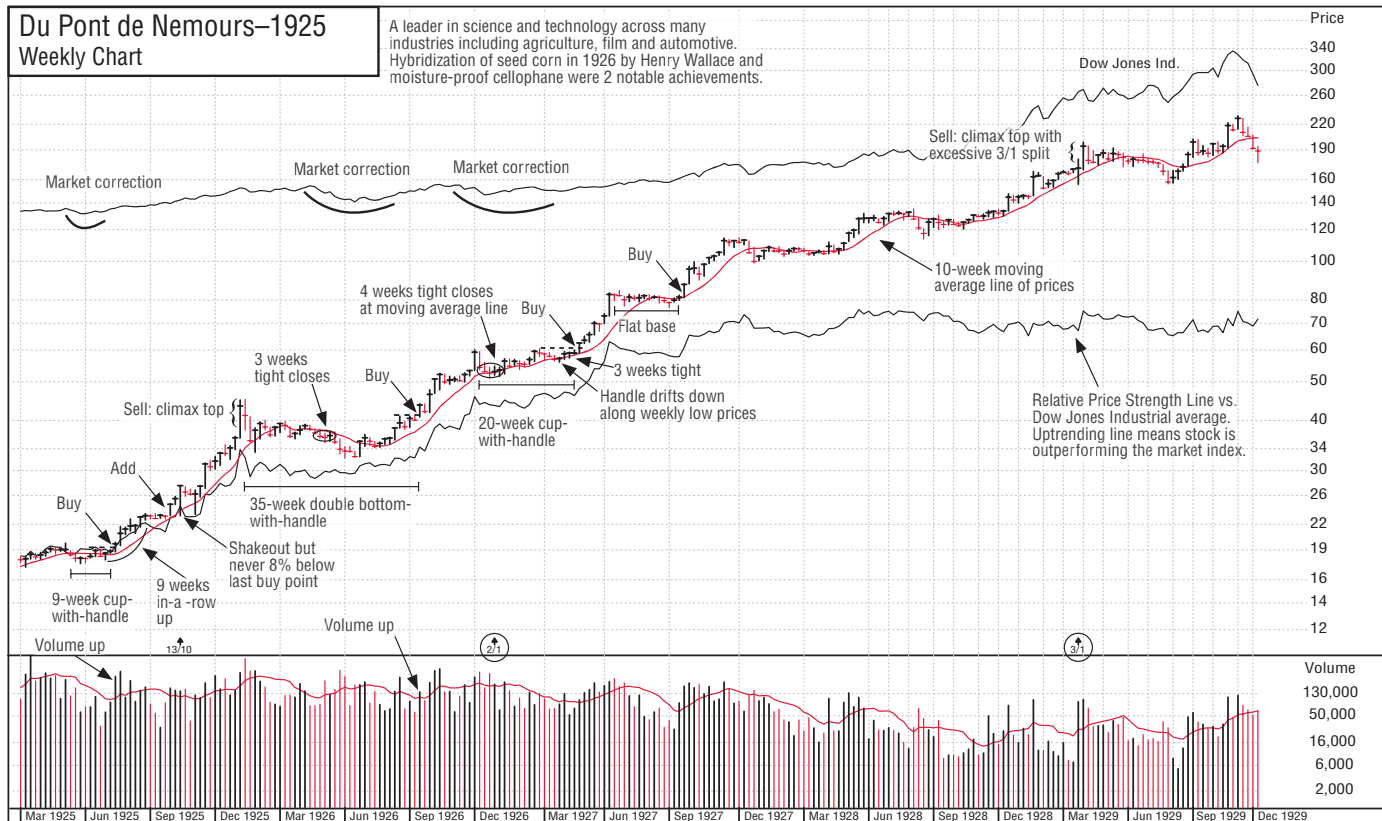
The new public utilities industry was growing rapidly as more homes and businesses were wired for electricity. The public's living standard rises again.



Utah Securities increased 538% in 63 weeks.

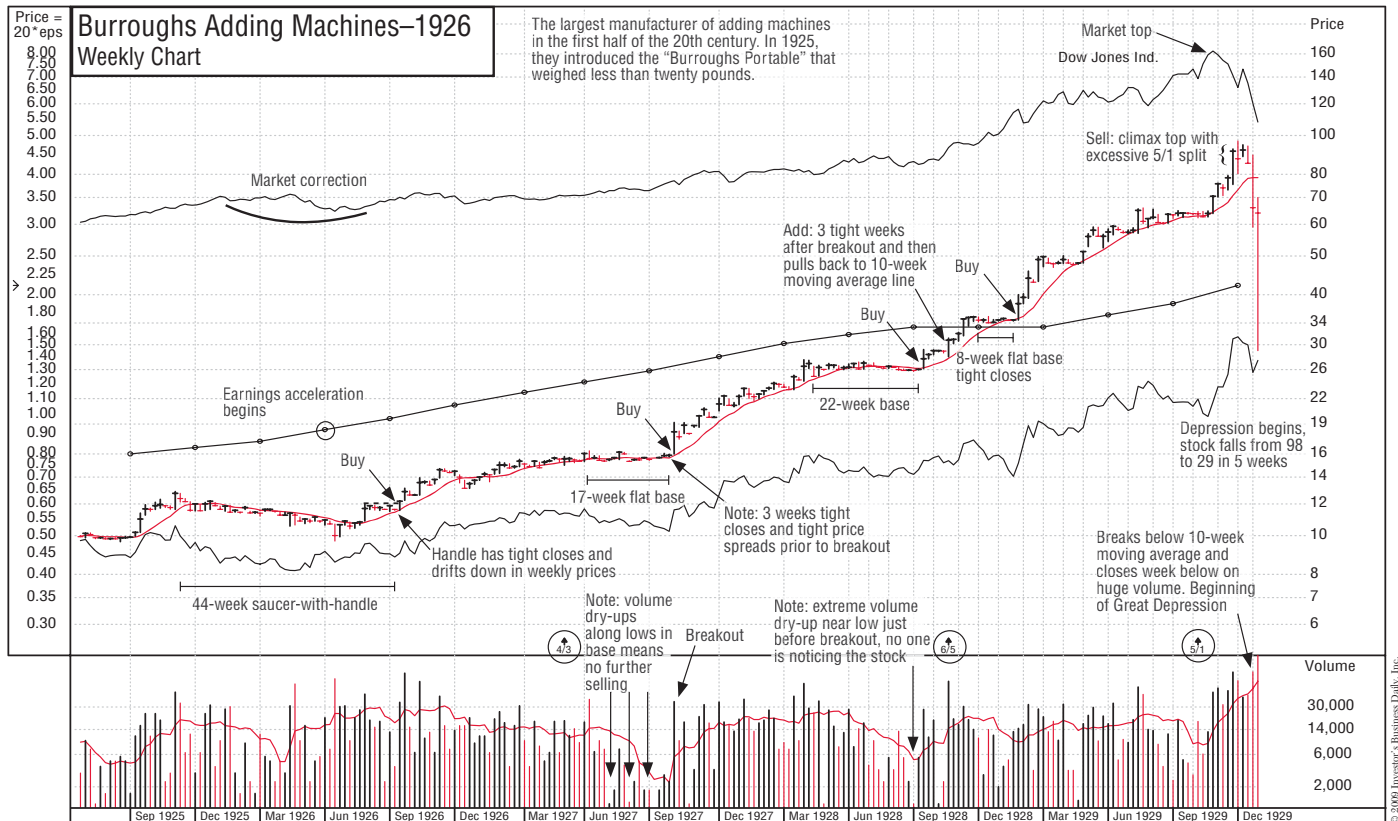
Du Pont de Nemours-1925 Weekly Chart

A leader in science and technology across many industries including agriculture, film and automotive. Hybridization of seed corn in 1926 by Henry Wallace and moisture-proof cellophane were 2 notable achievements.

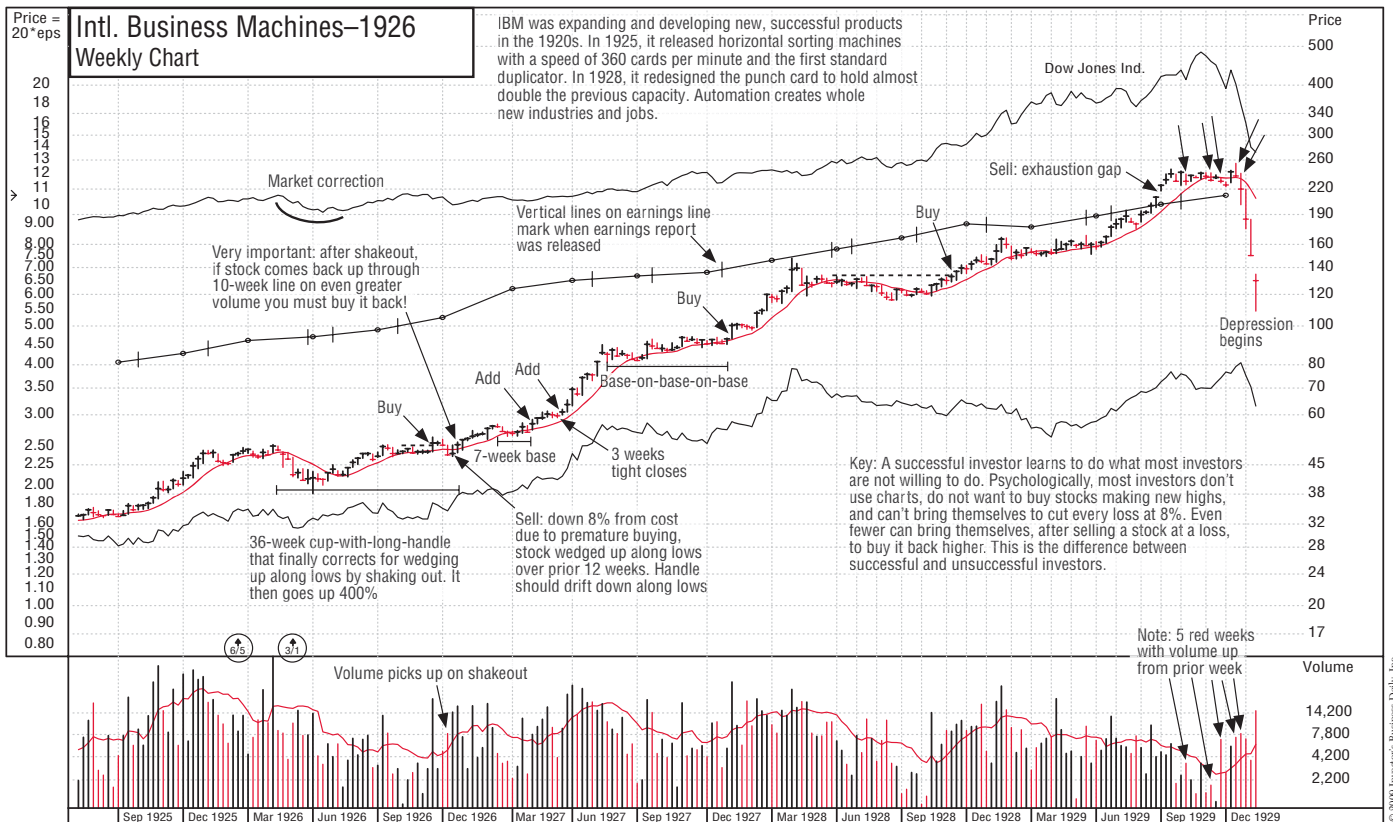


Du Pont de Nemours increased 1074% in 225 weeks.

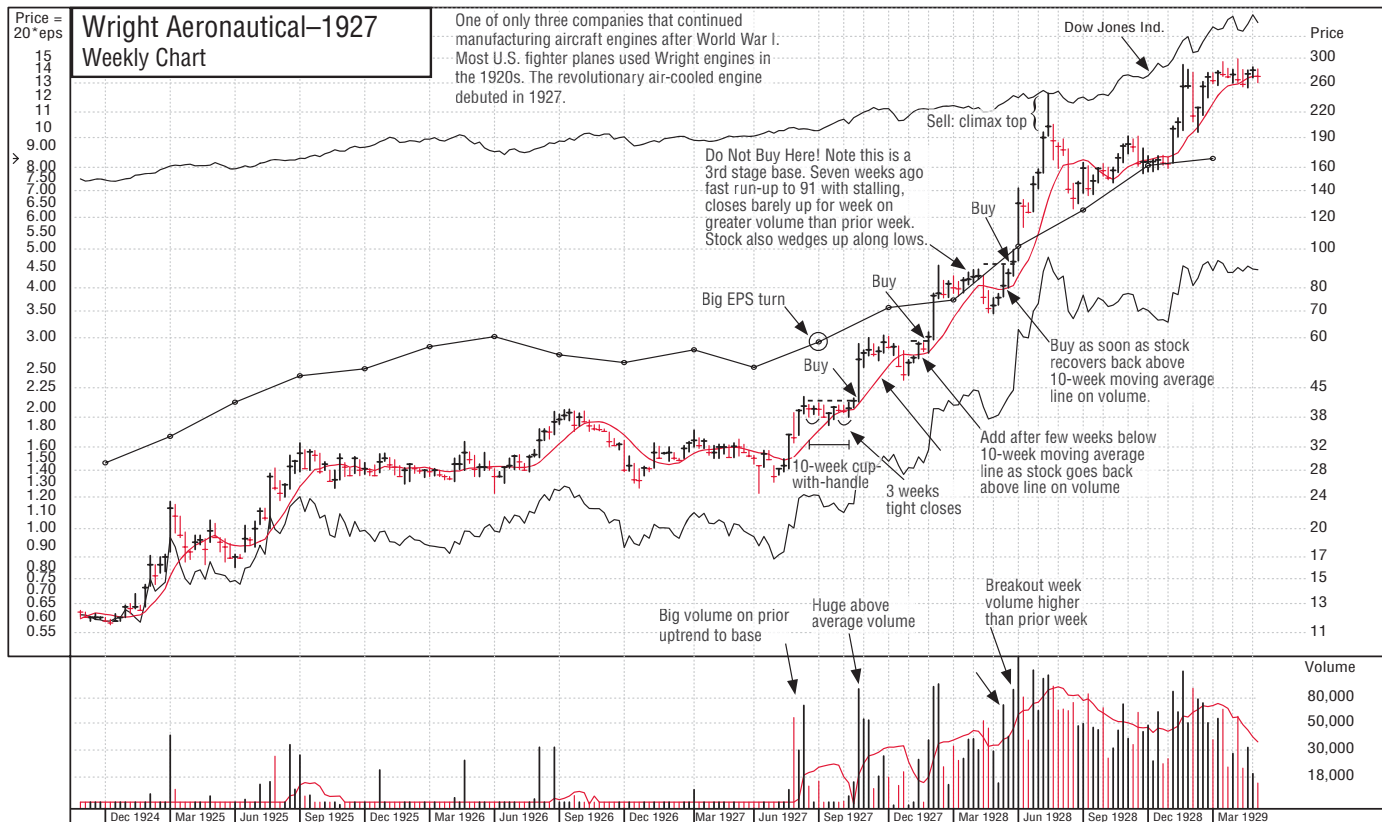
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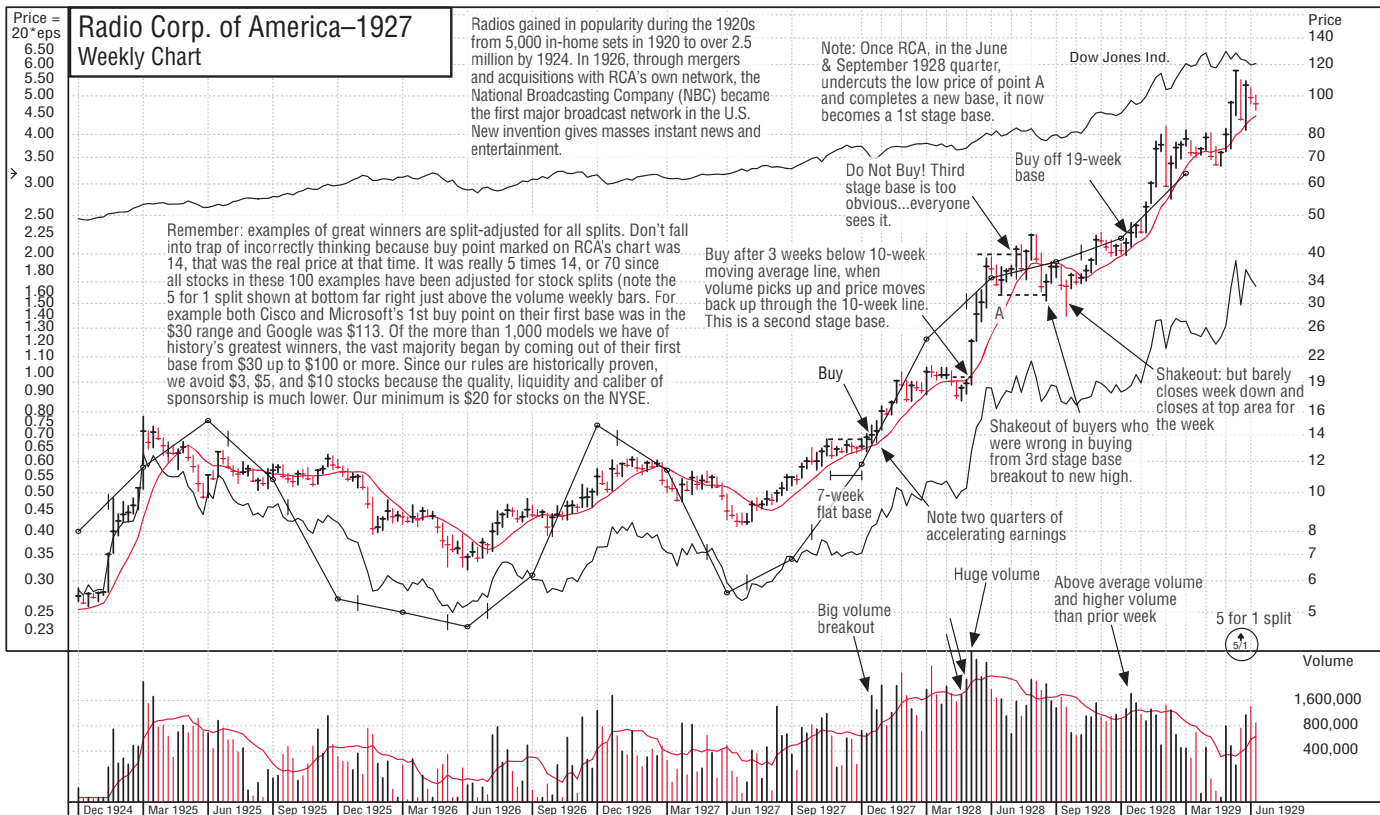
Burroughs Adding Machines increased 1992% in 168 weeks.



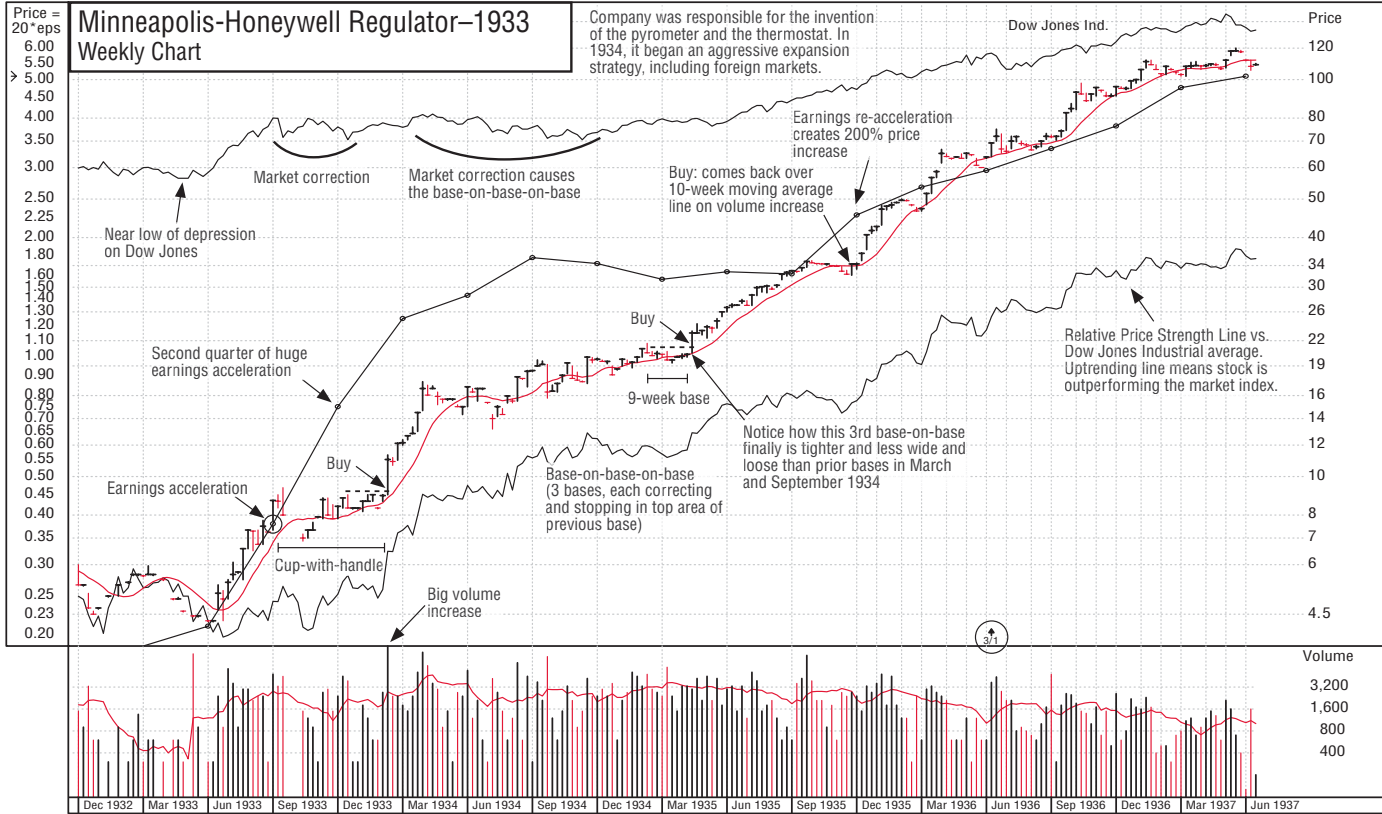
International Business Machines increased 400% in 161 weeks.



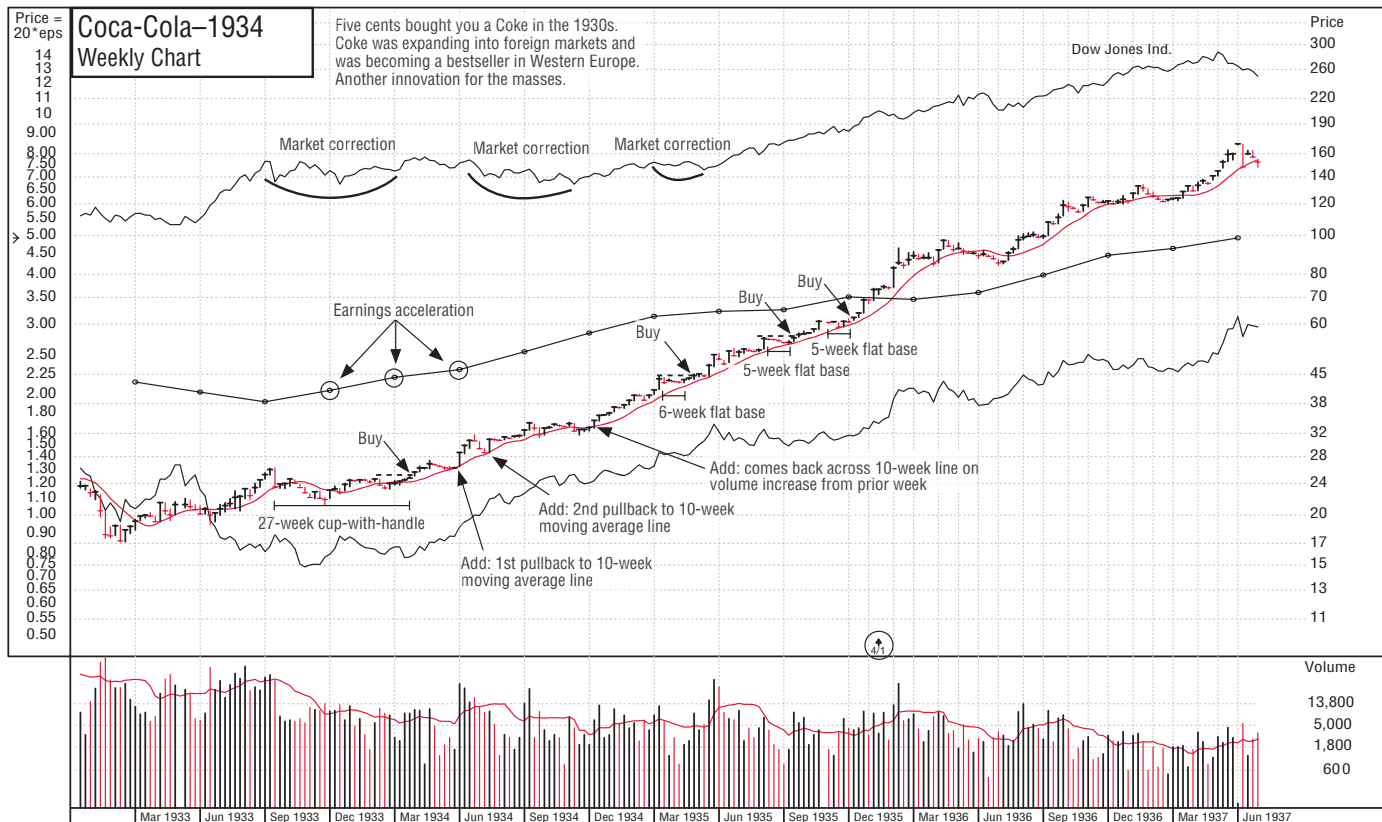
Wright Aeronautical increased 464% in 76 weeks.



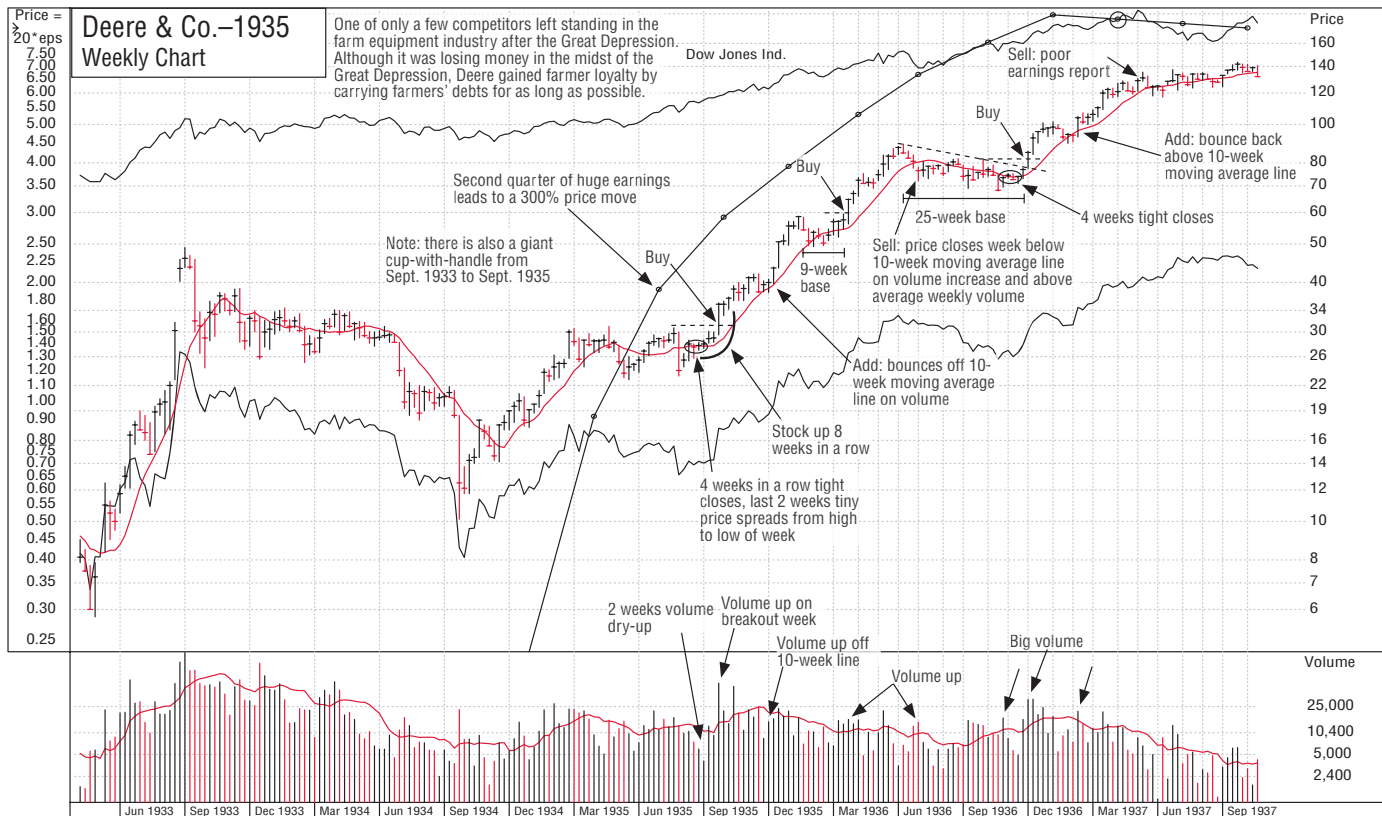
Radio Corporation of America increased 739% in 74 weeks.



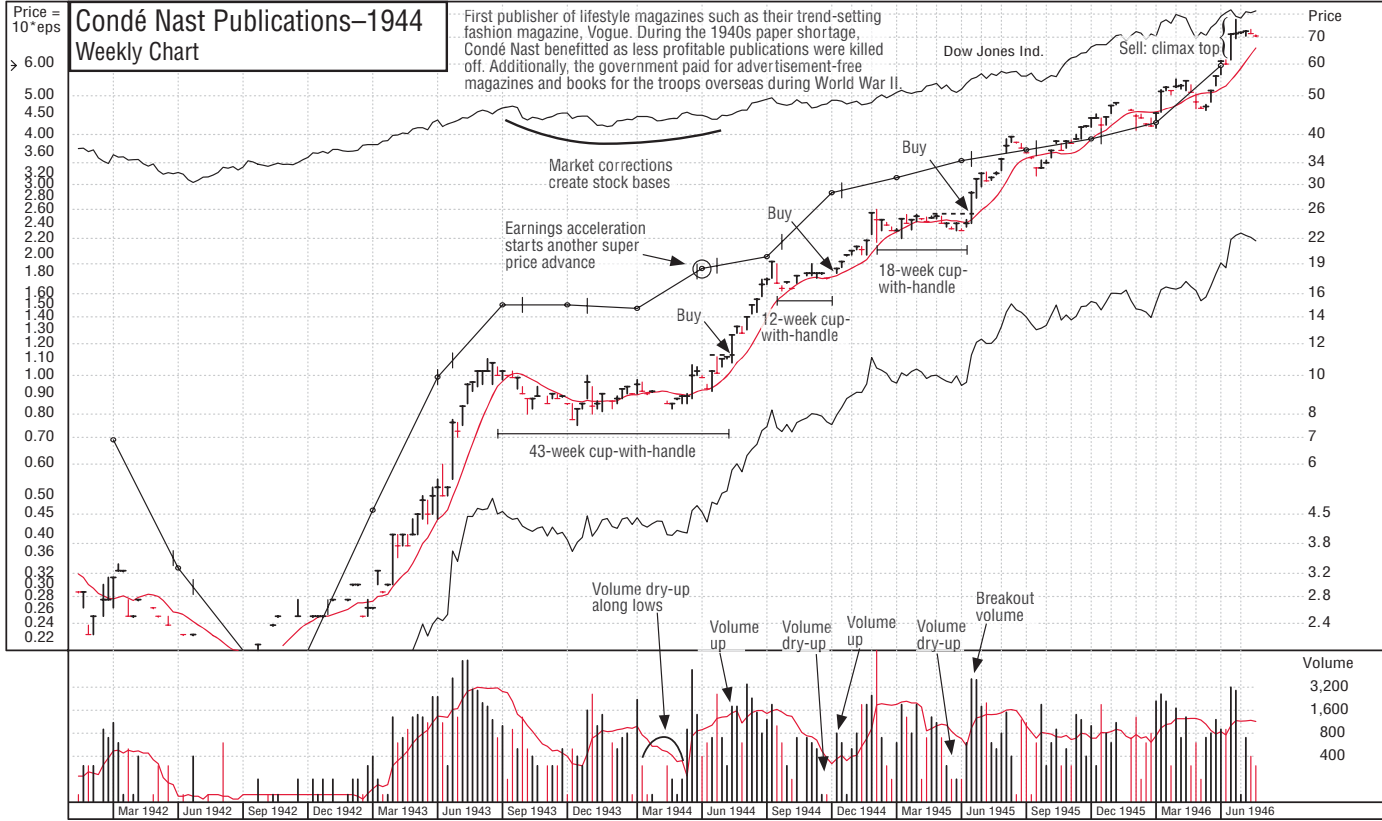
Minneapolis-Honeywell Regulator increased 987% in 170 weeks.



Coca-Cola increased 565% in 165 weeks.



Deere & Co increased 307% in 104 weeks.

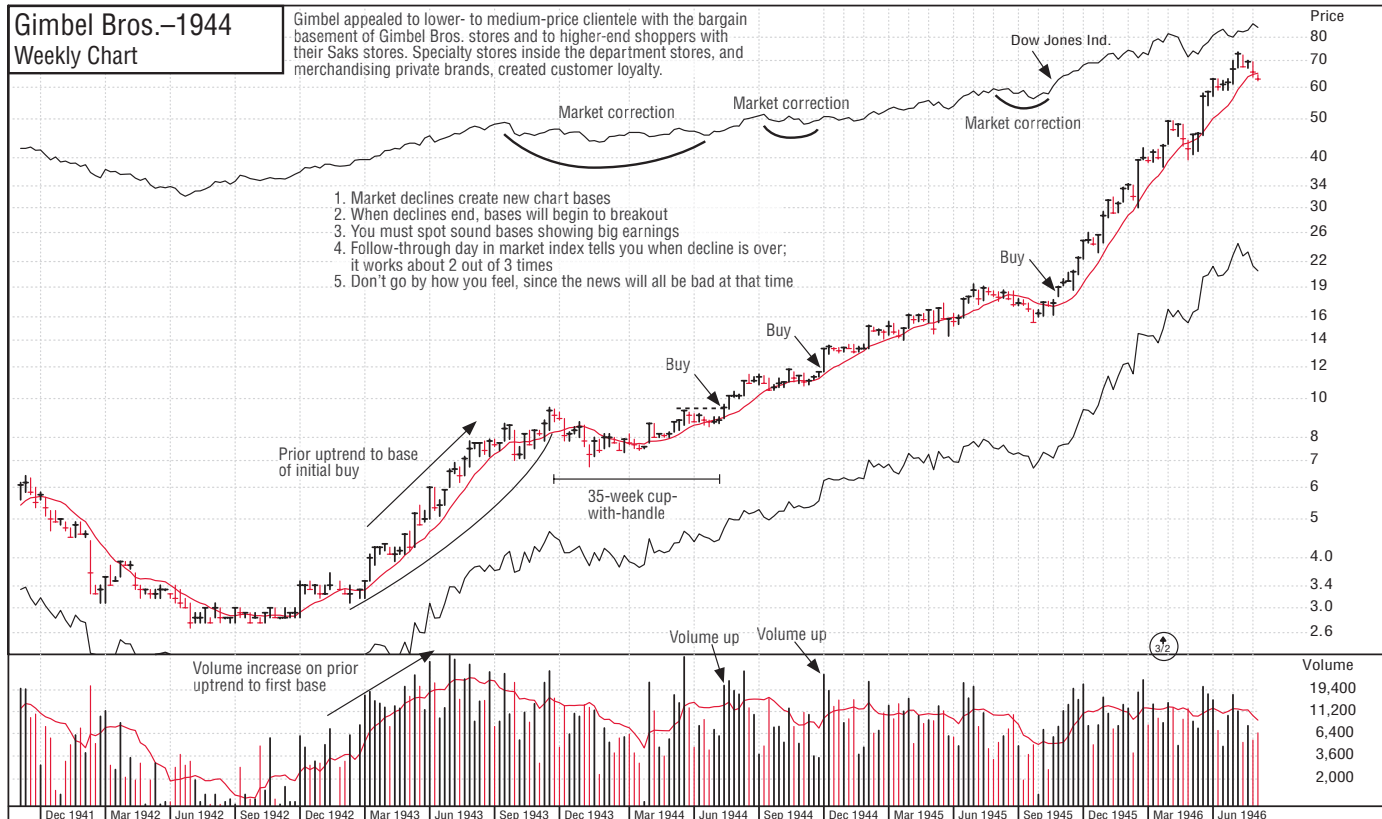


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Condé Nast Publications increased 514% in 101 weeks.

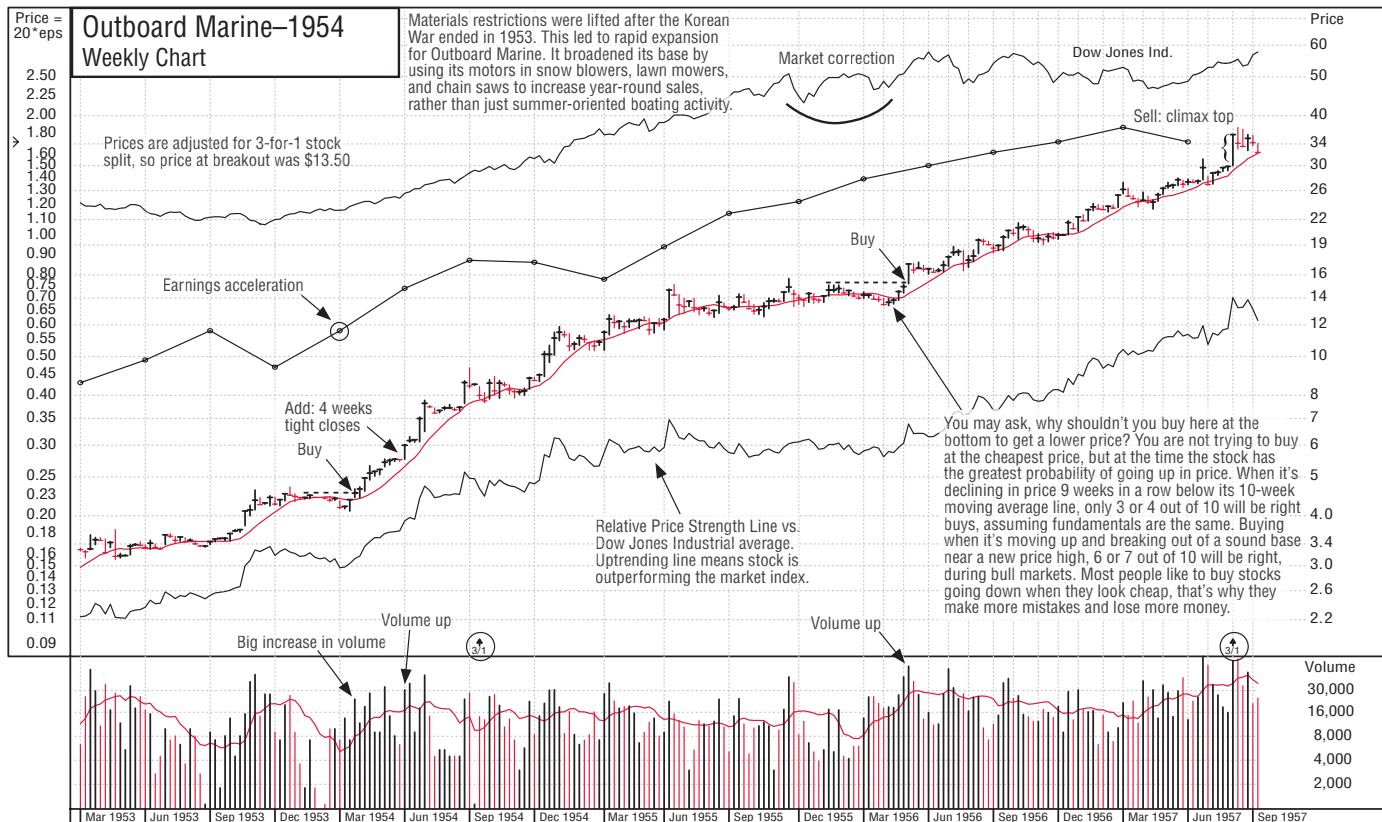
Gimbel Bros.-1944 Weekly Chart

Gimbel appealed to lower- to medium-price clientele with the bargain basement of Gimbel Bros. stores and to higher-end shoppers with their Saks stores. Specialty stores inside the department stores, and merchandising private brands, created customer loyalty.



Gimbel Brothers increased 674% in 103 weeks.

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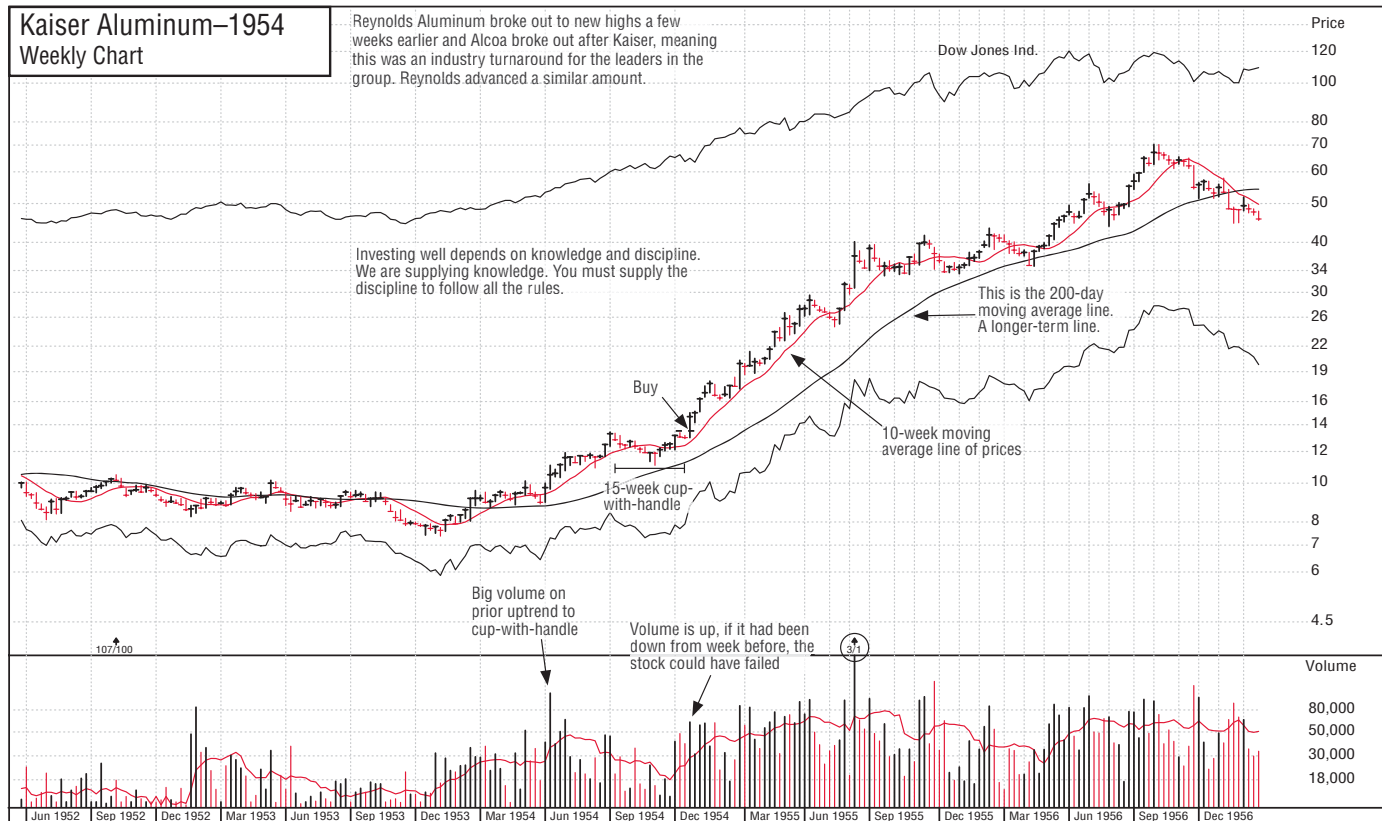


Outboard Marine increased 720% in 177 weeks.

Kaiser Aluminum—1954 Weekly Chart

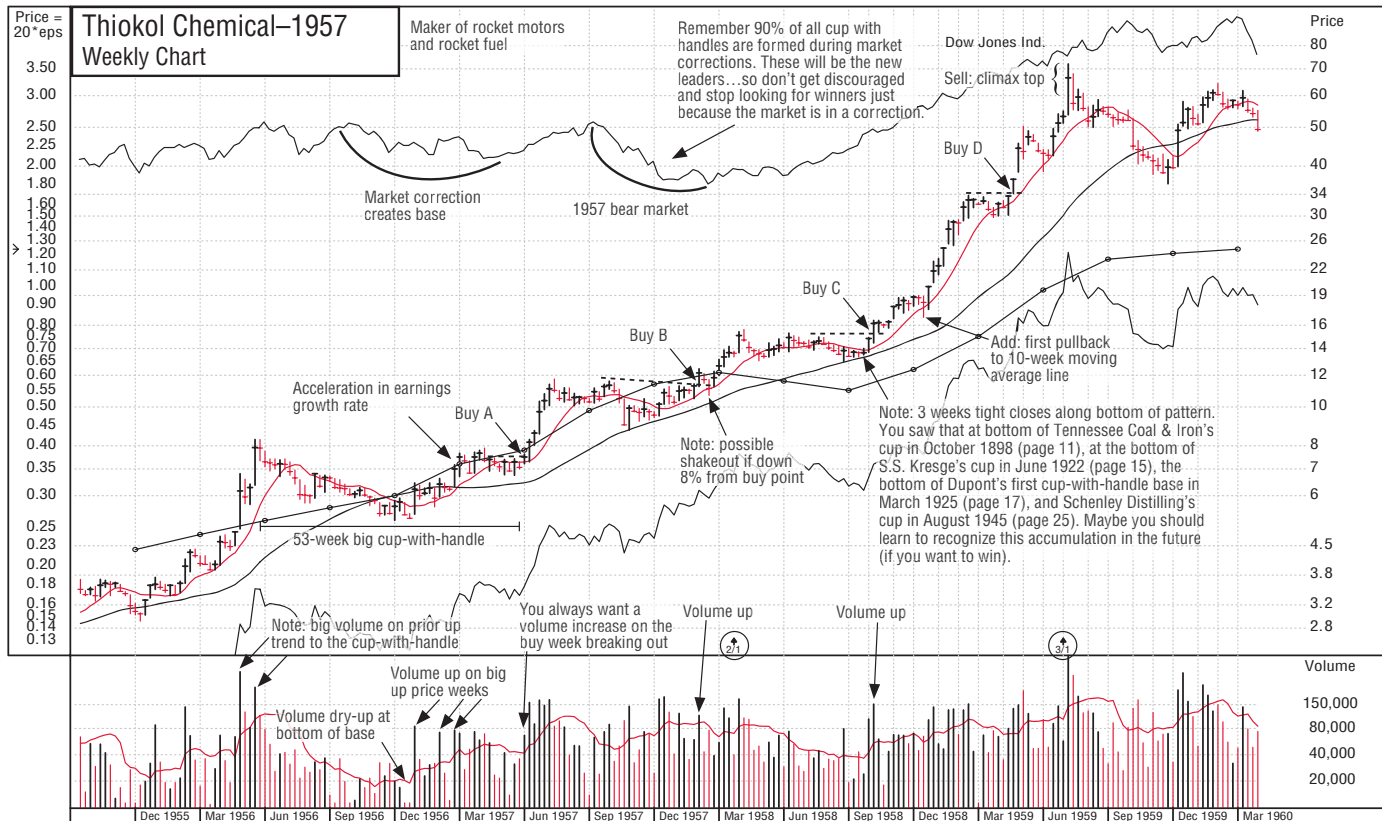
Reynolds Aluminum broke out to new highs a few weeks earlier and Alcoa broke out after Kaiser, meaning this was an industry turnaround for the leaders in the group. Reynolds advanced a similar amount.

Investing well depends on knowledge and discipline. We are supplying knowledge. You must supply the discipline to follow all the rules.

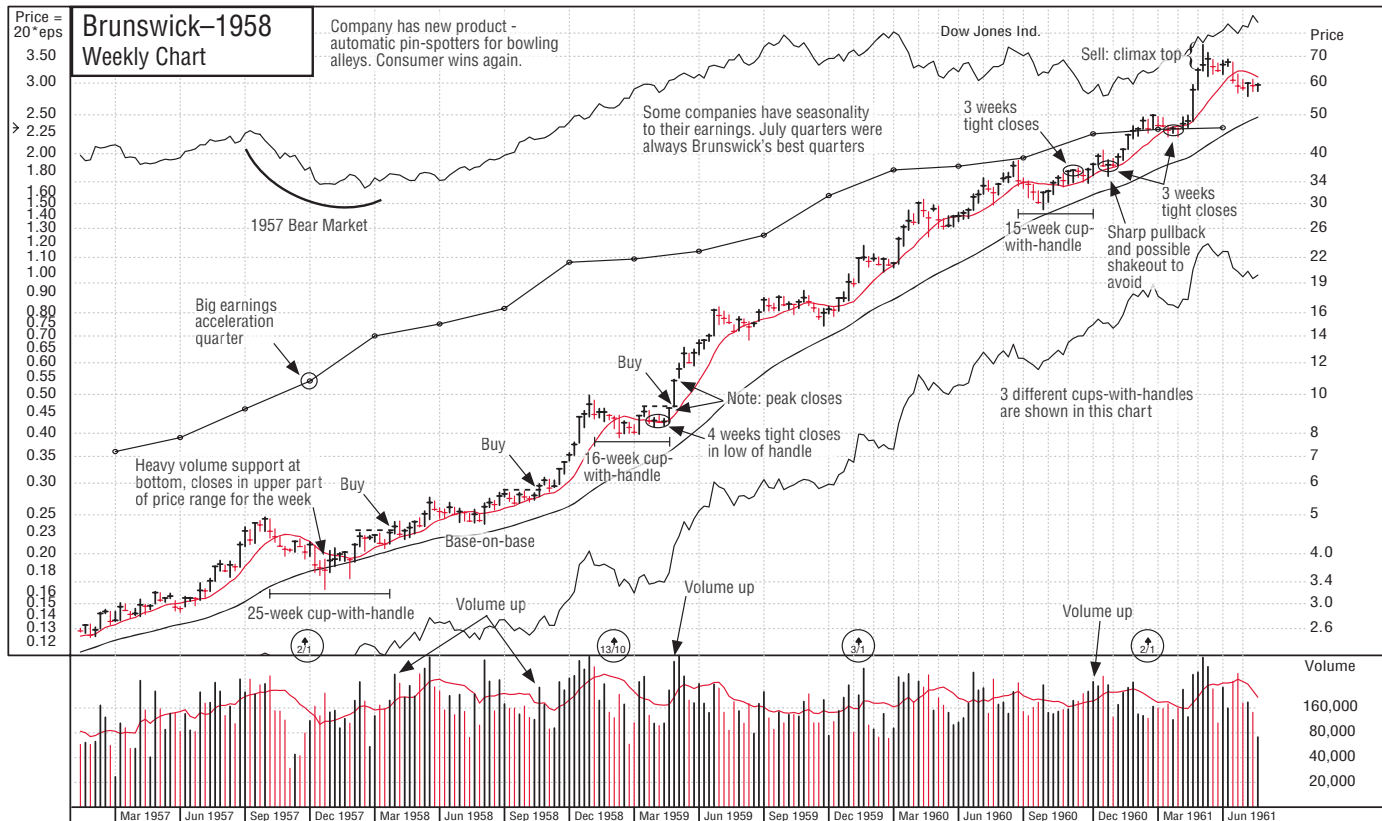


Kaiser Aluminum increased 379% in 93 weeks.

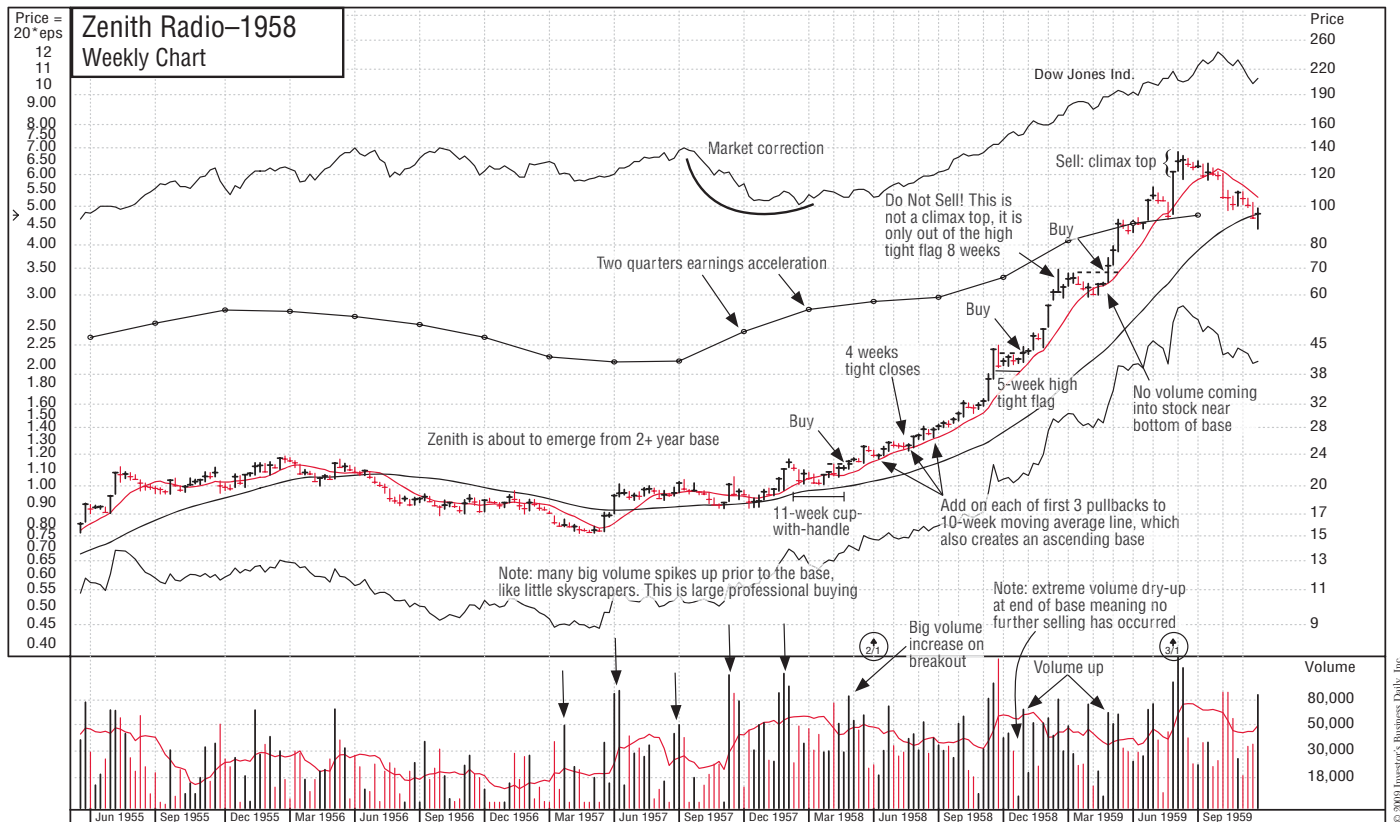
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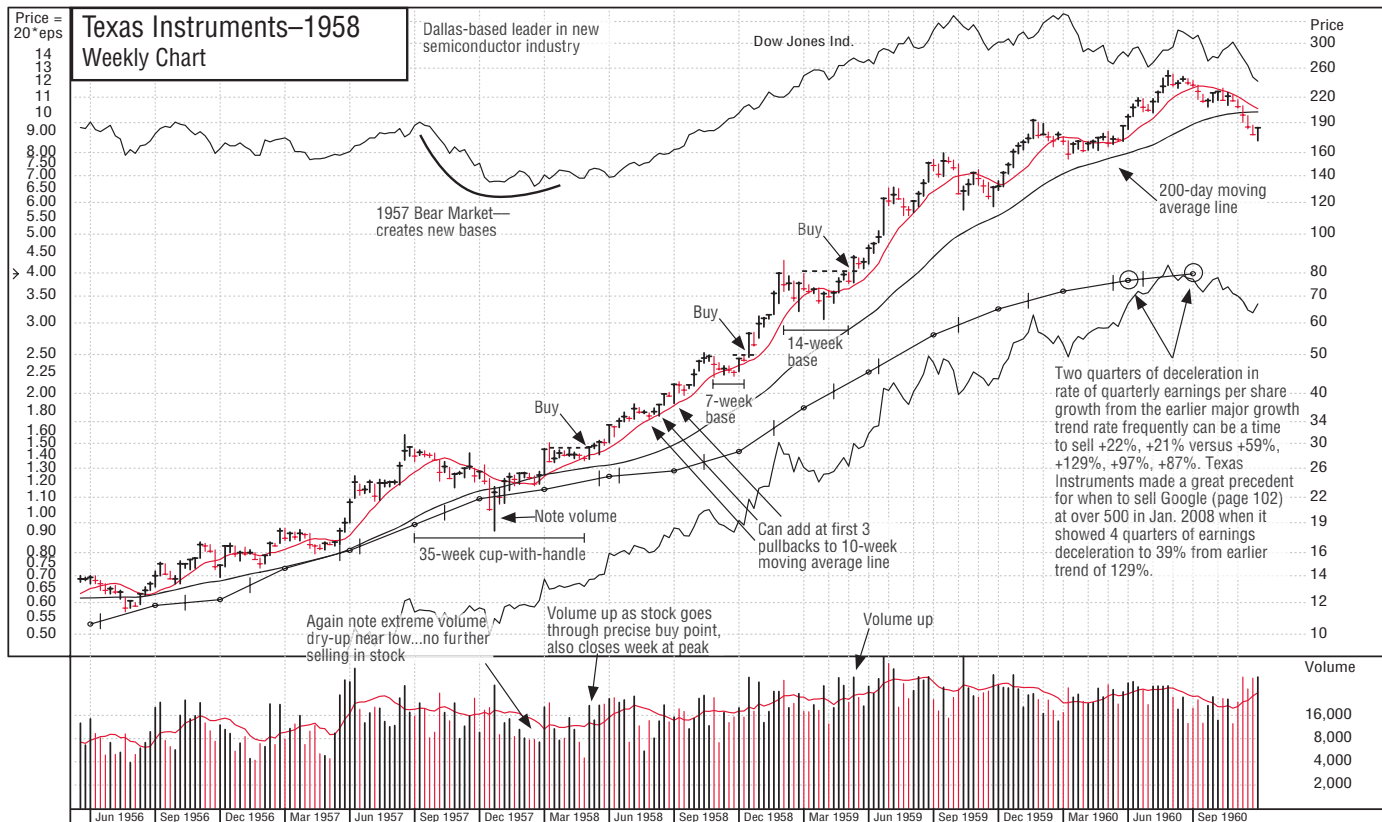
Thiokol Chemical increased 860% in 109 weeks.



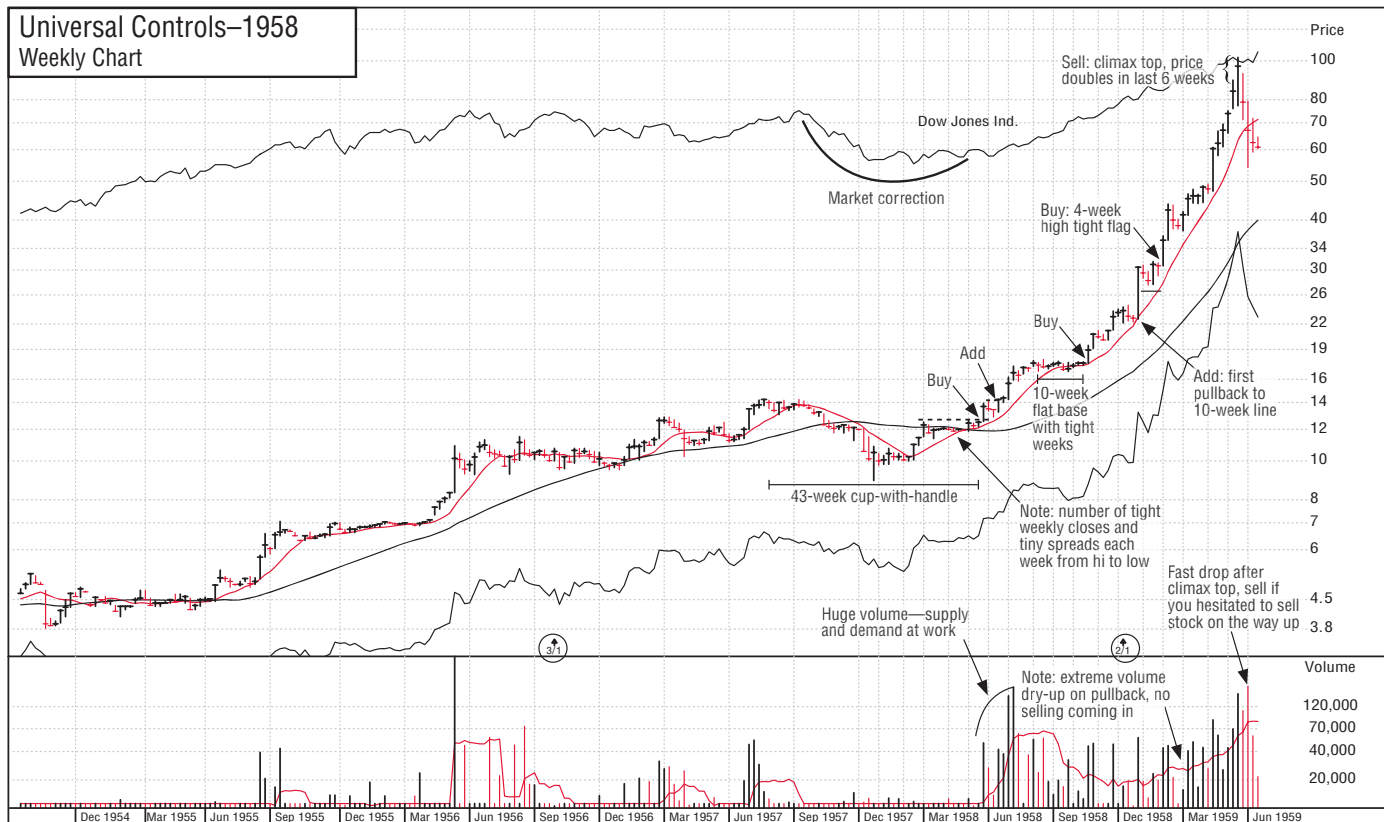
Brunswick increased 1500% in 162 weeks.



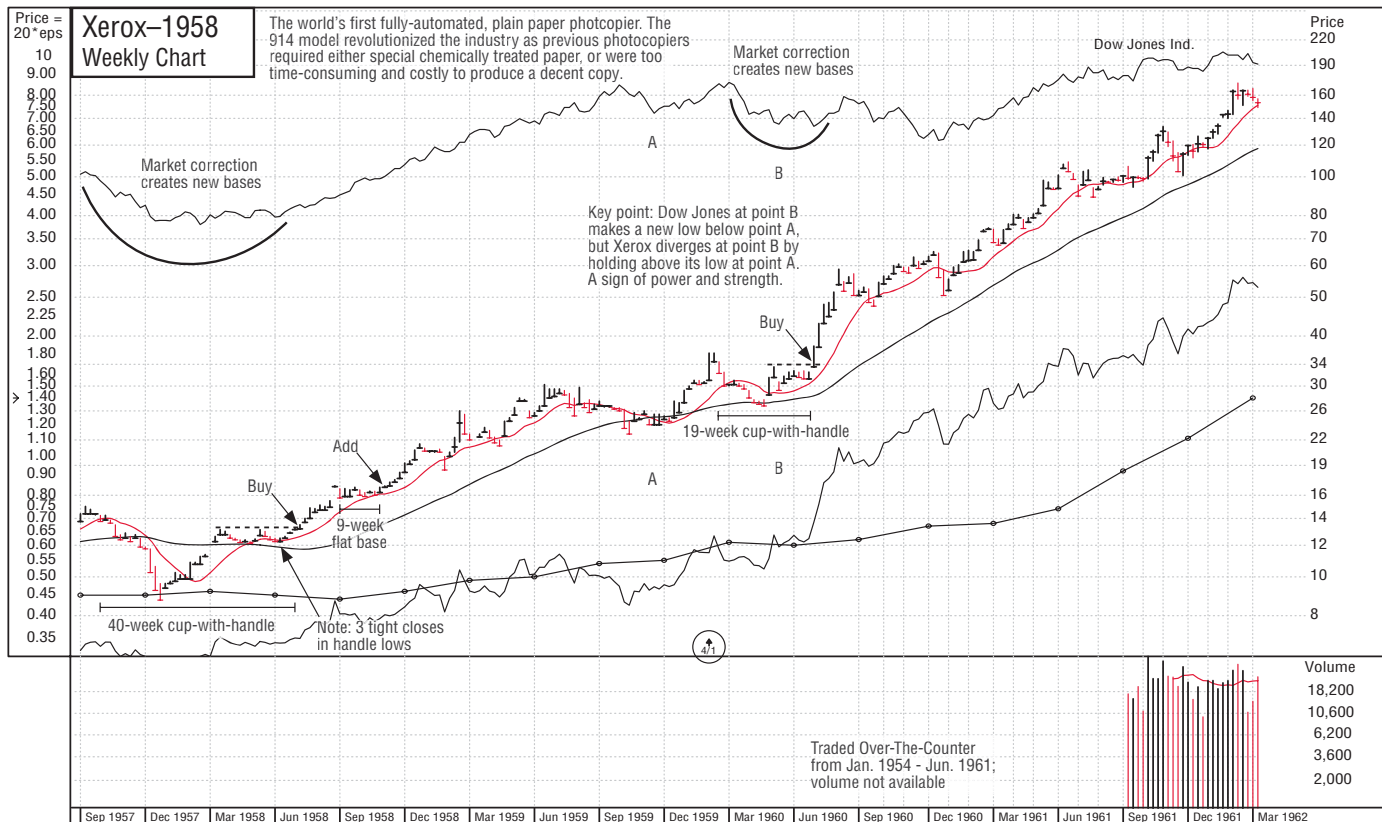
Zenith Radio increased 493% in 66 weeks.



Texas Instruments increased 772% in 116 weeks.



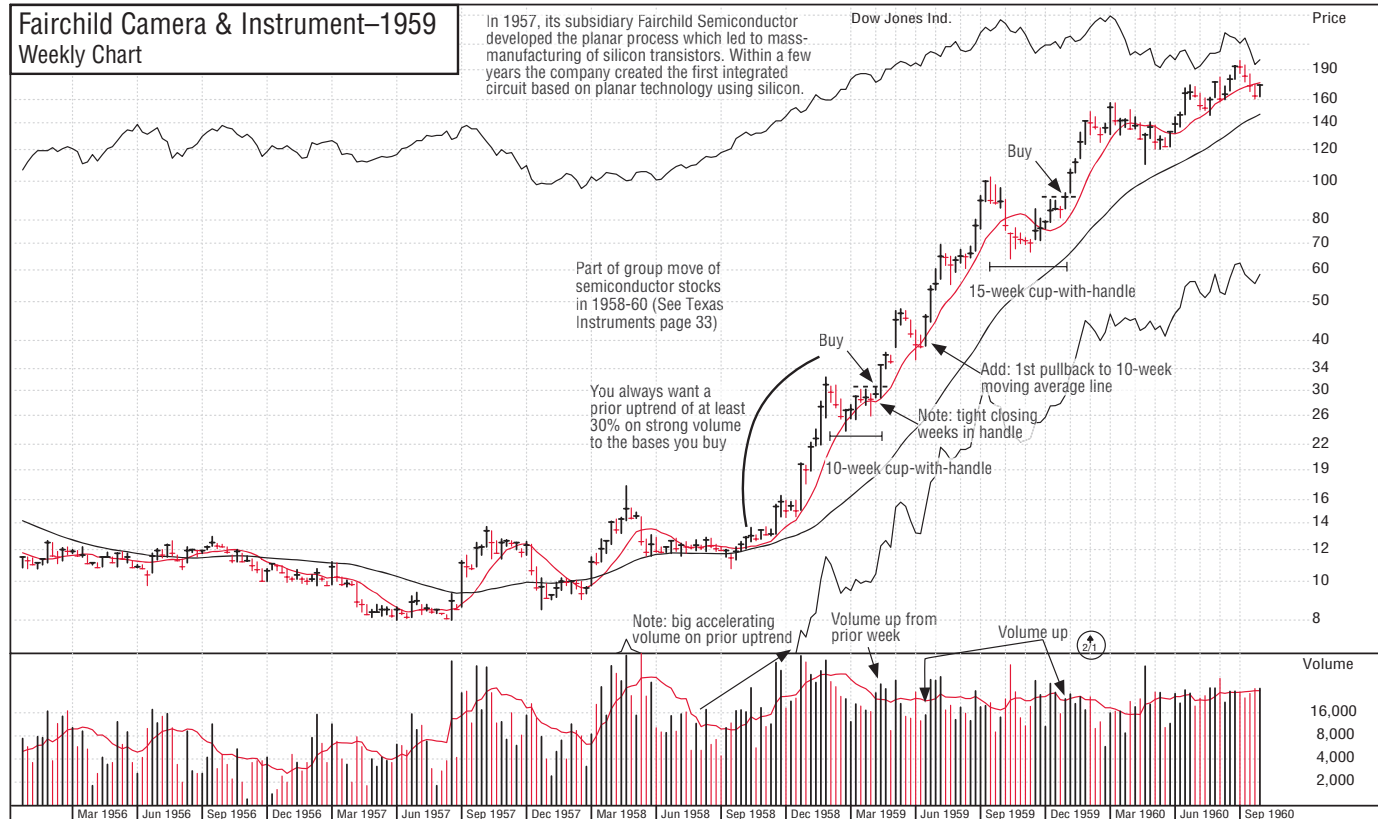
Universal Controls increased 645% in 51 weeks.



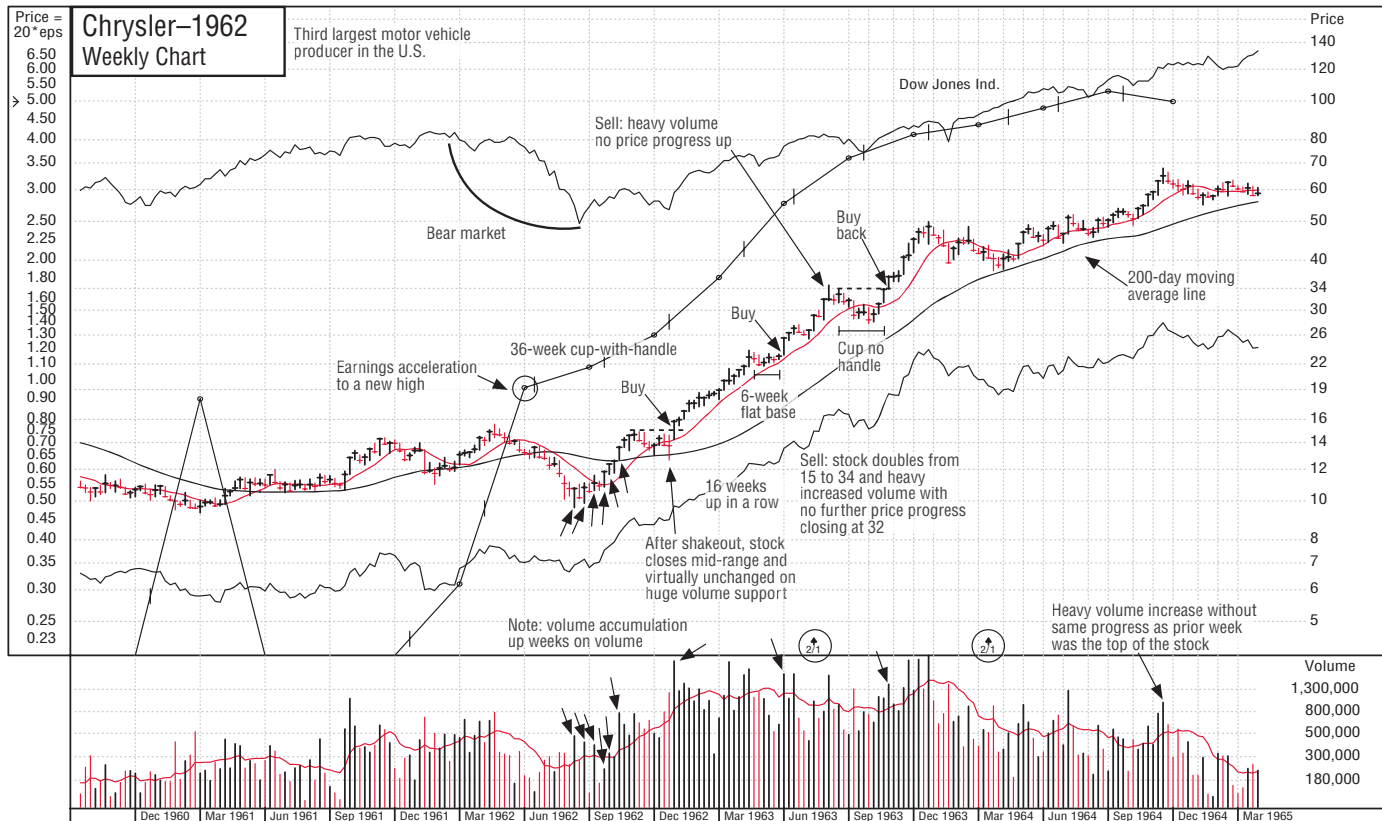
Xerox increased 1201% in 188 weeks.

Fairchild Camera & Instrument-1959 Weekly Chart

In 1957, its subsidiary Fairchild Semiconductor developed the planar process which led to mass-manufacturing of silicon transistors. Within a few years the company created the first integrated circuit based on planar technology using silicon.



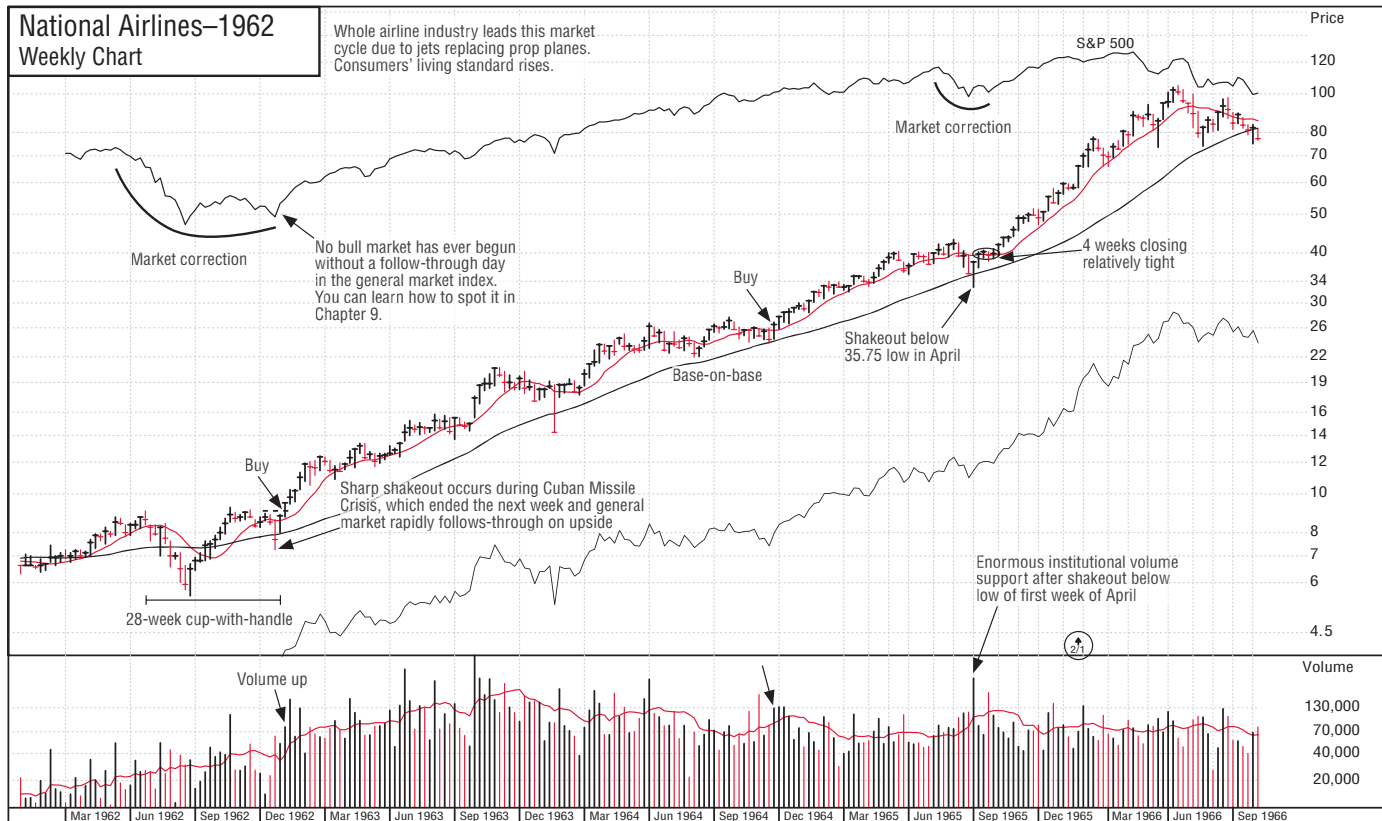
Fairchild Camera & Instrument increased 582% in 73 weeks.



Chrysler increased 215% in 51 weeks.

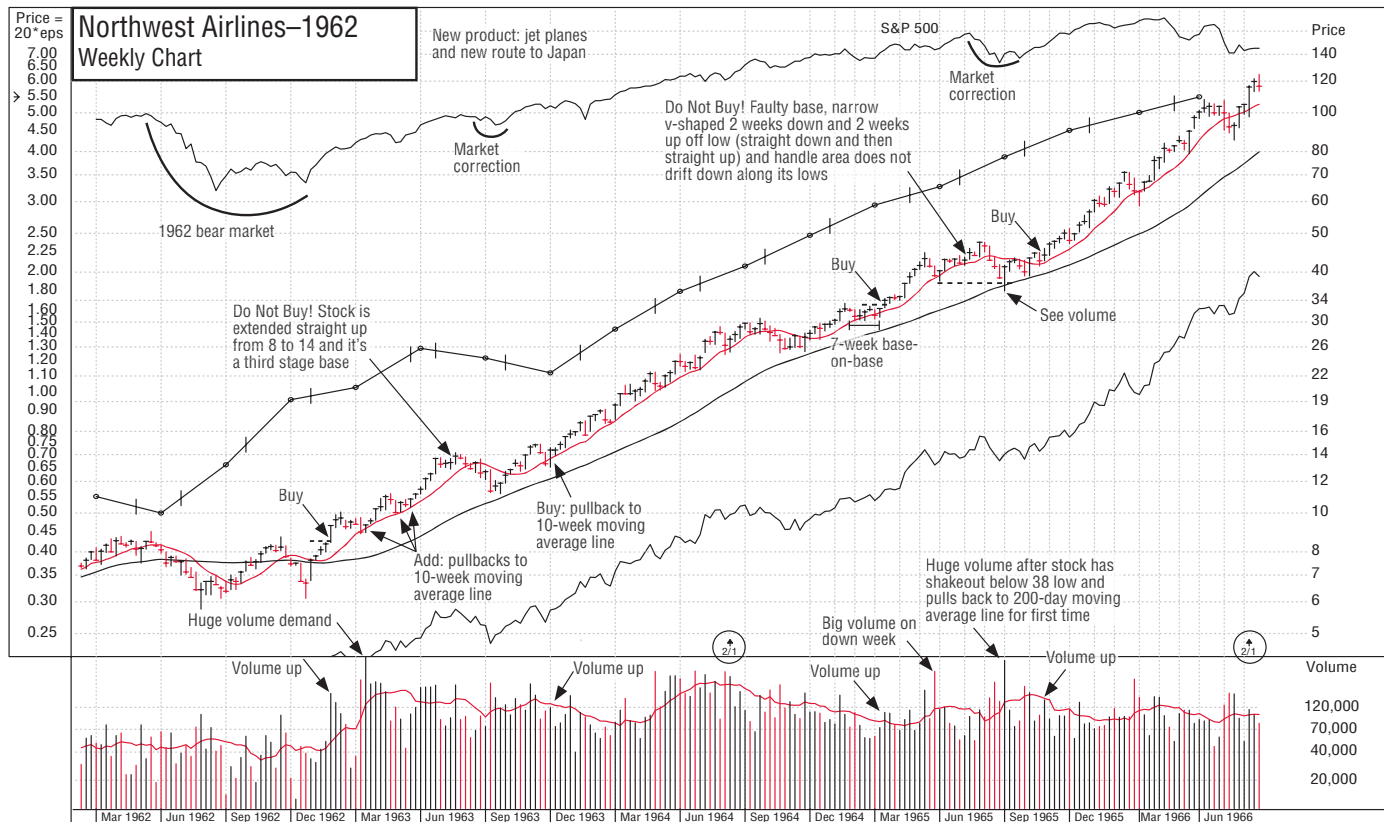
National Airlines–1962 Weekly Chart

Whole airline industry leads this market cycle due to jets replacing prop planes. Consumers' living standard rises.

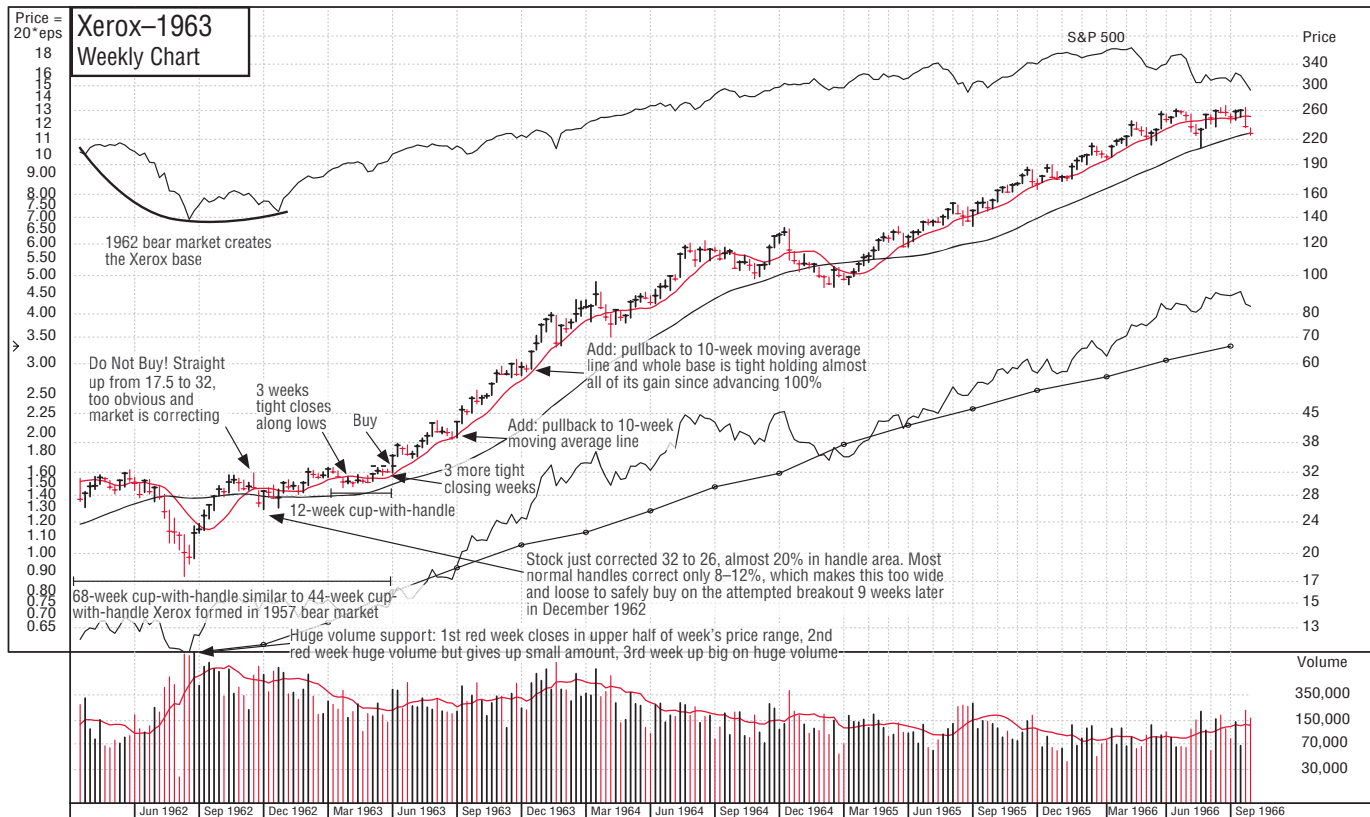


National Airlines increased 1004% in 179 weeks.

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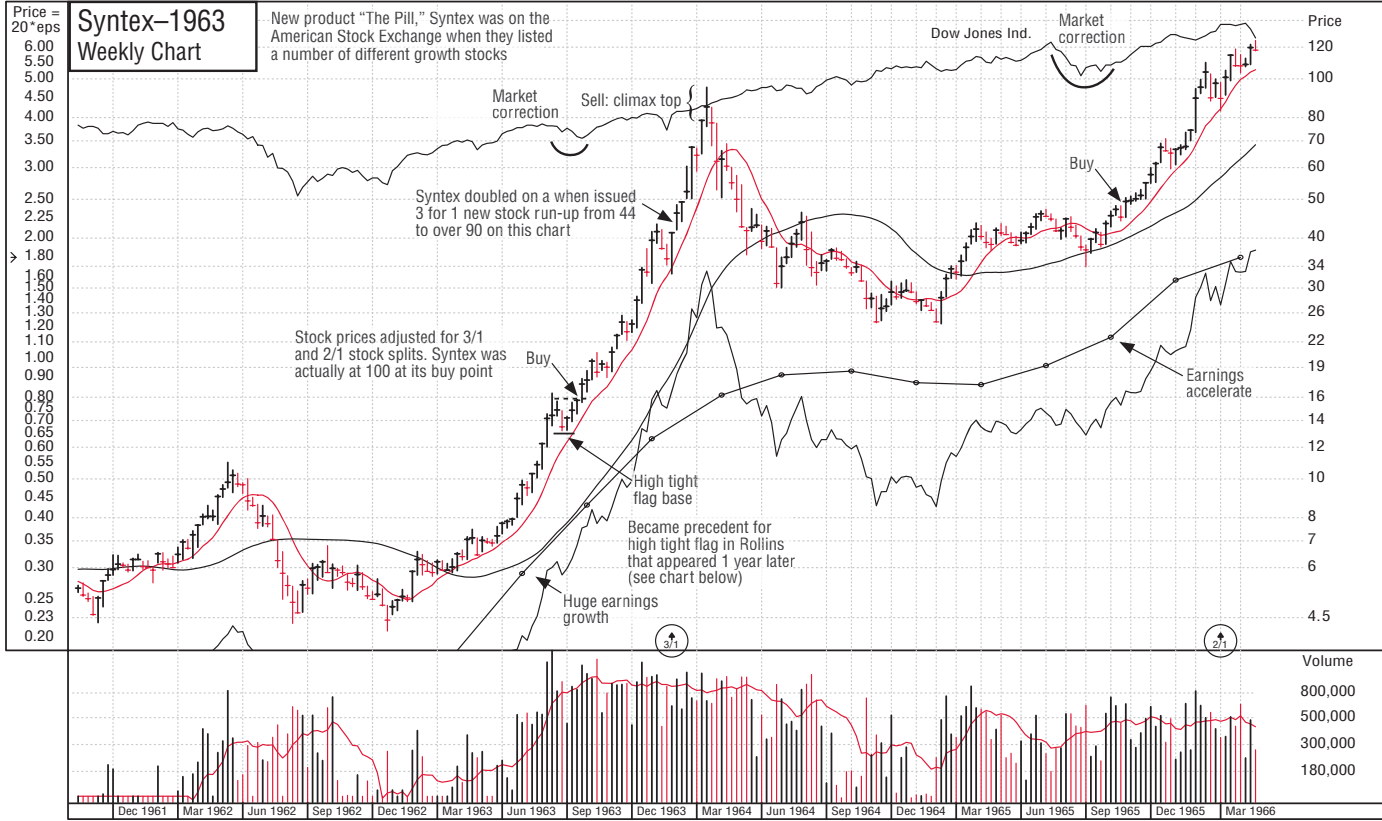


Northwest Airlines increased 1240% in 186 weeks.



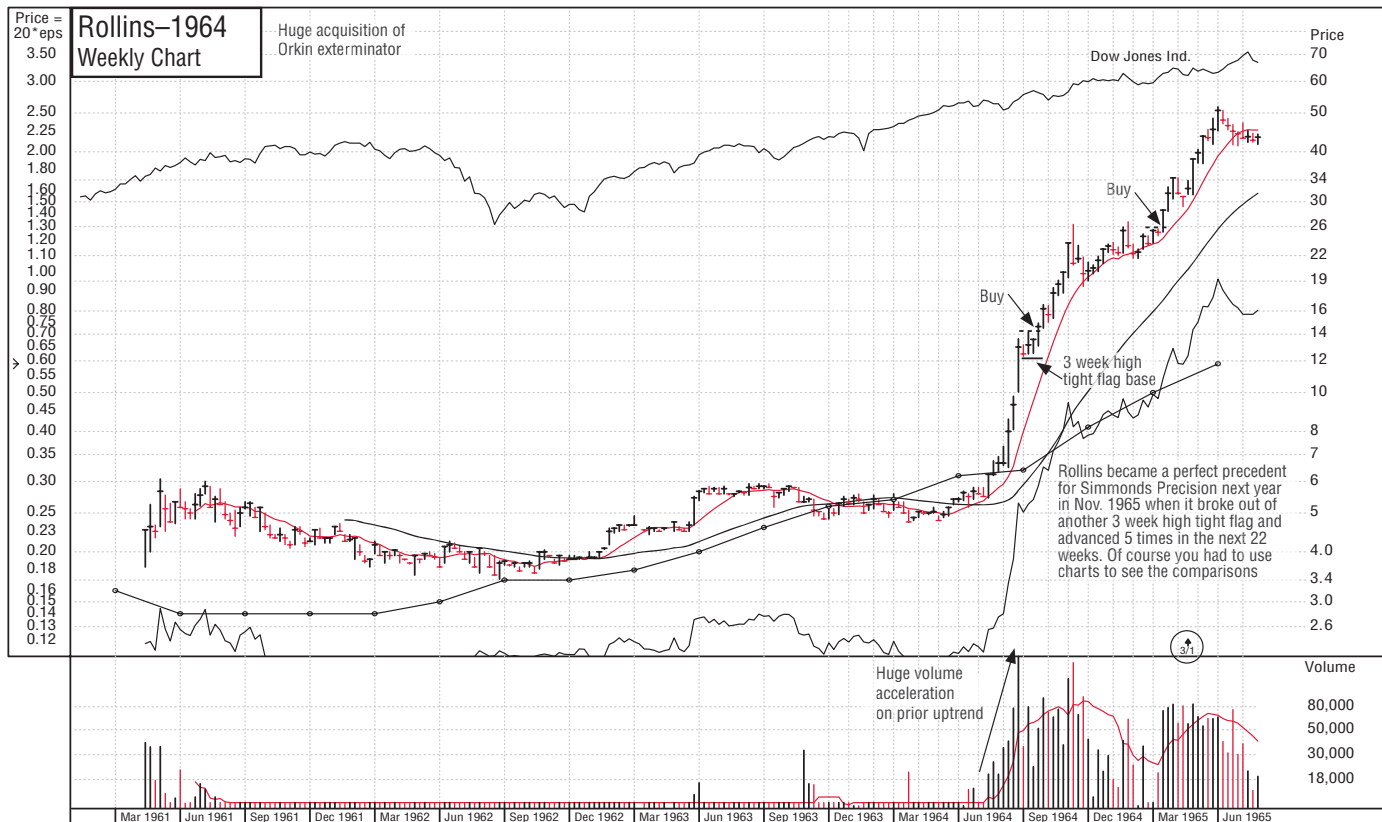
Xerox increased 660% in 168 weeks.

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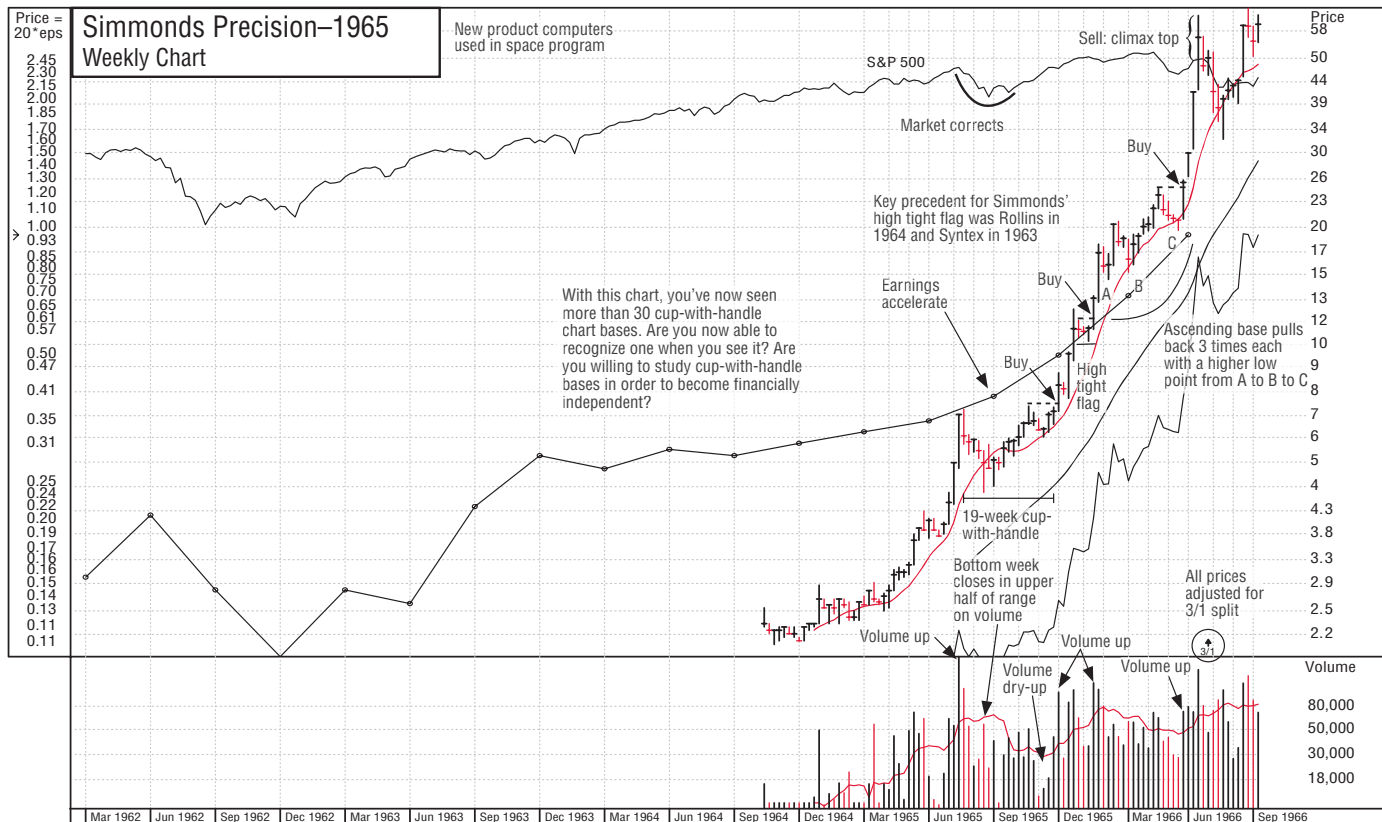


Syntex increased 451% in 25 weeks.

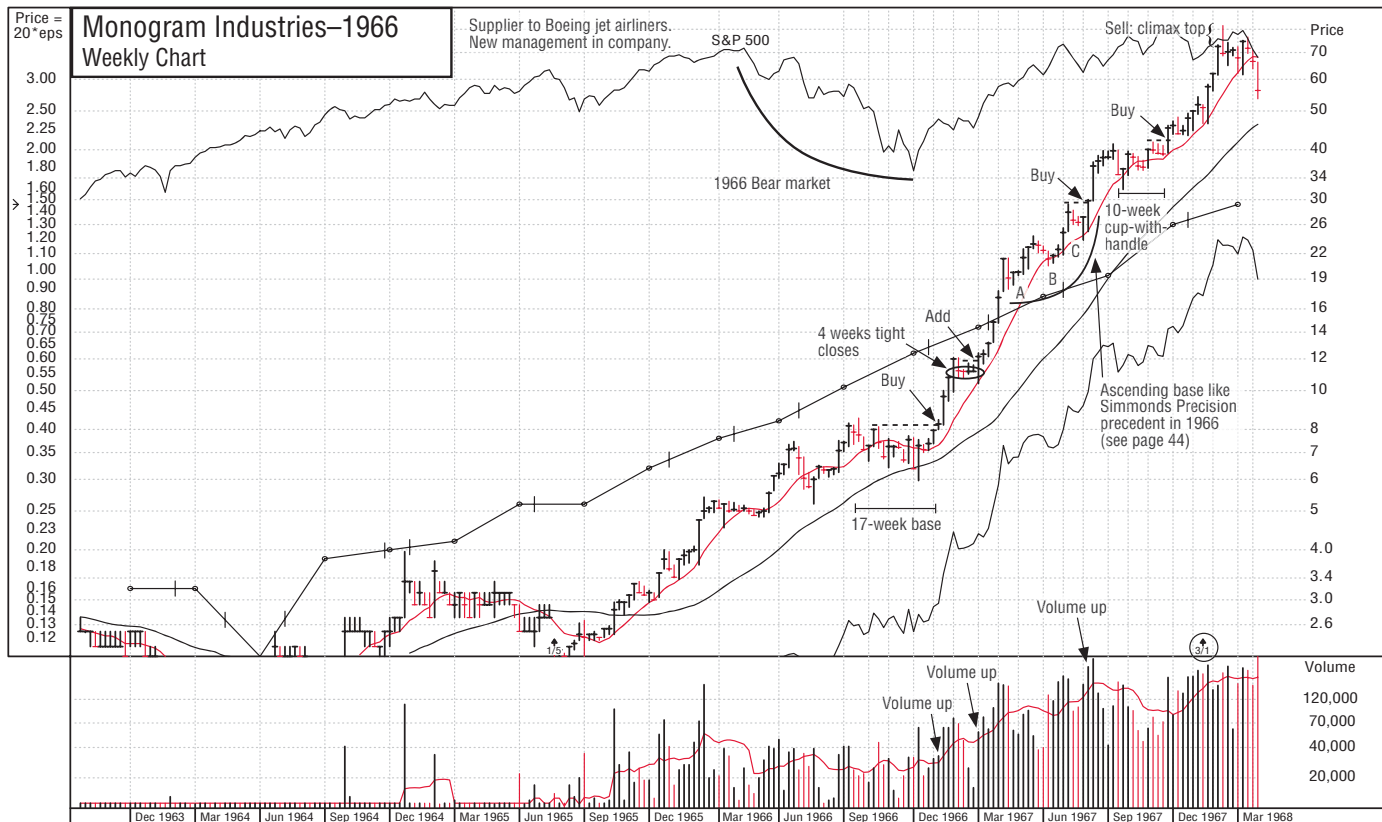
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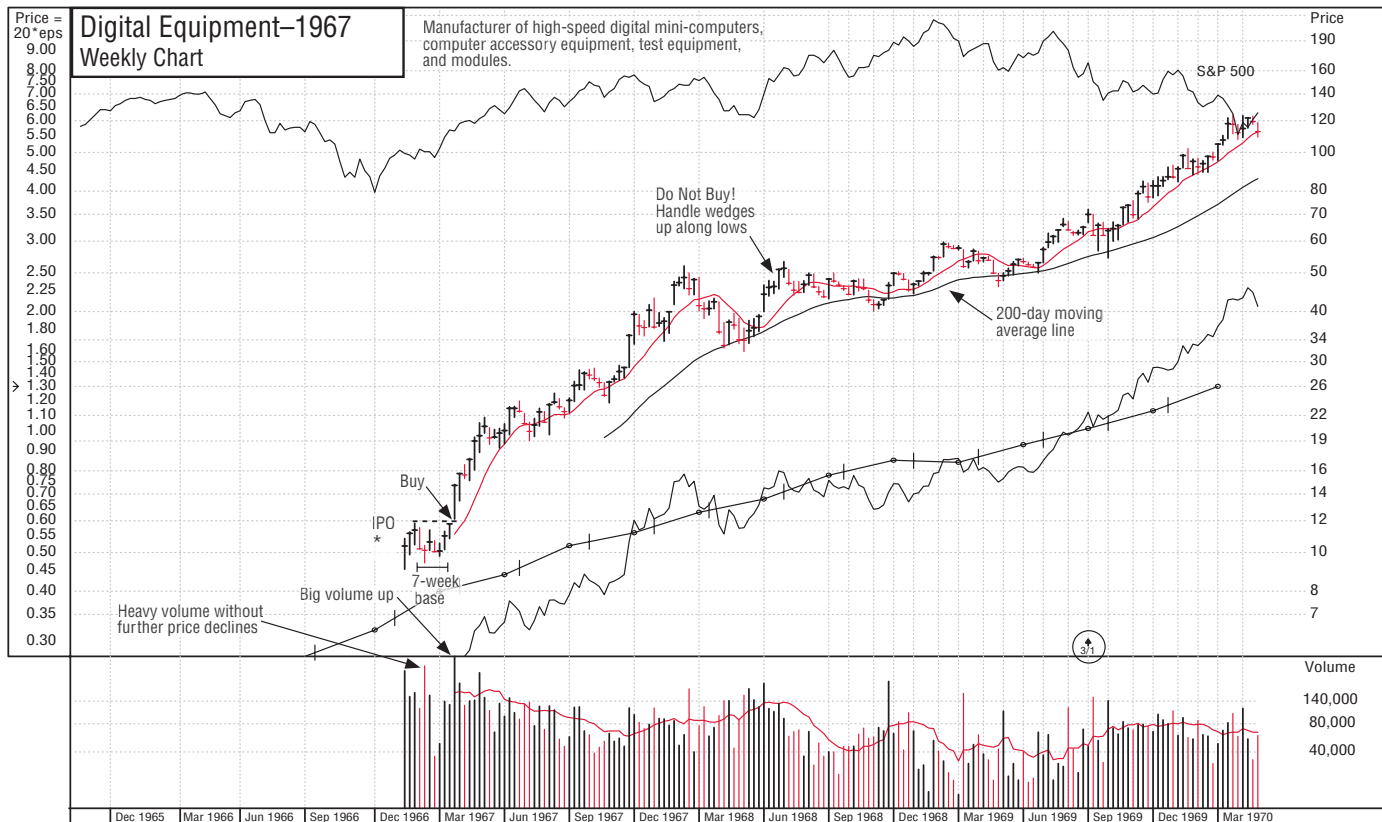
Rollins increased 254% in 36 weeks.



Simmonds Precision Products increased 672% in 38 weeks.

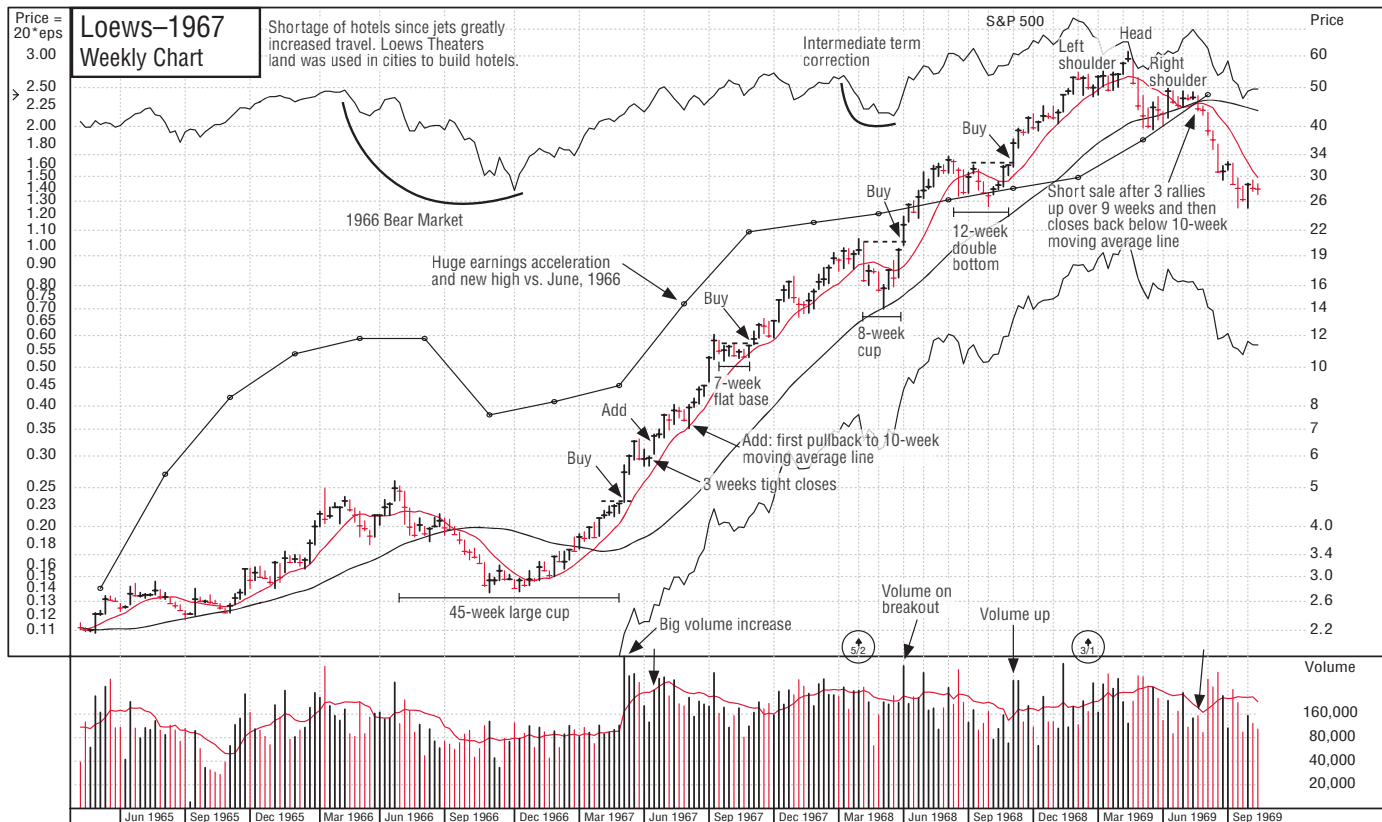


Monogram Industries increased 891% in 57 weeks.



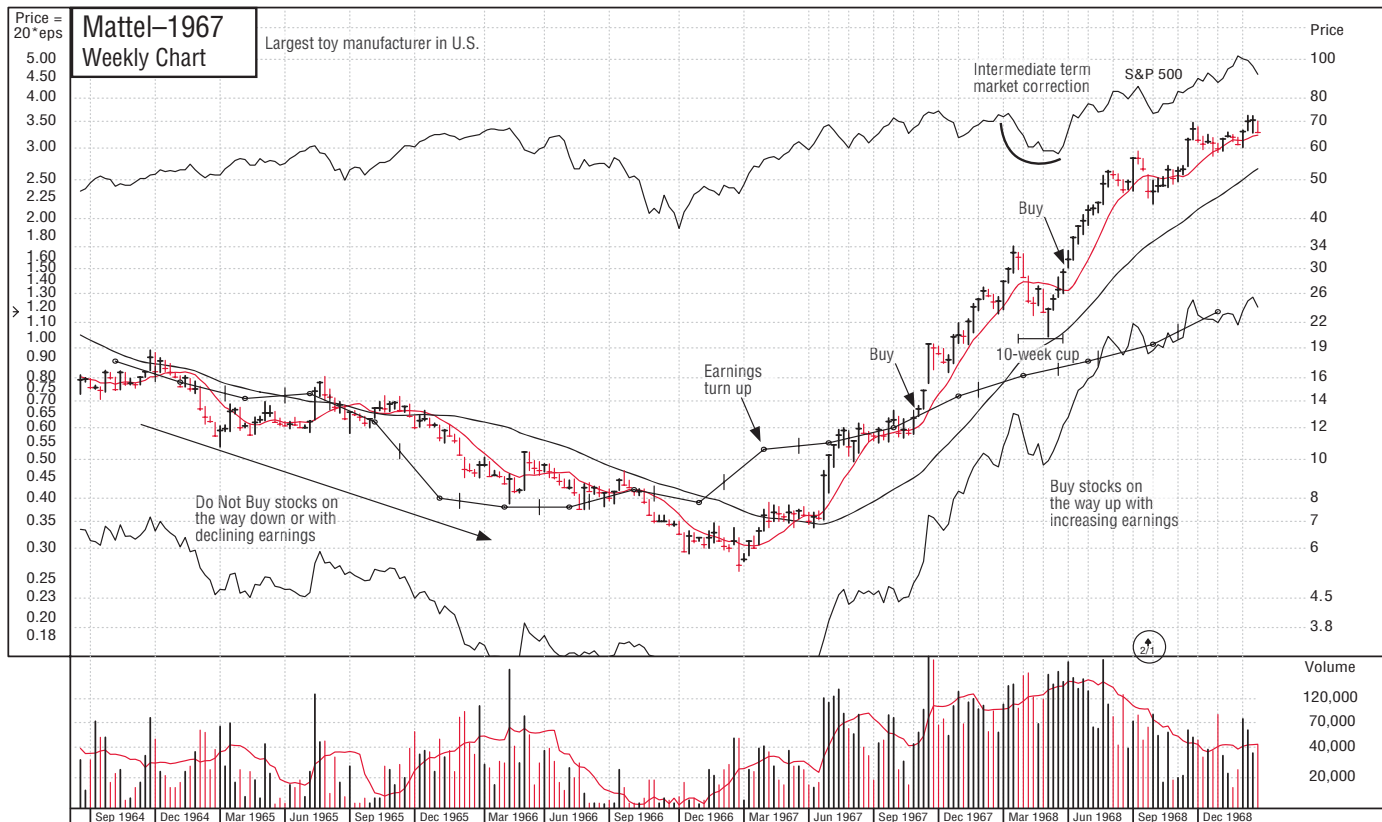
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Digital Equipment increased 743% in 156 weeks.



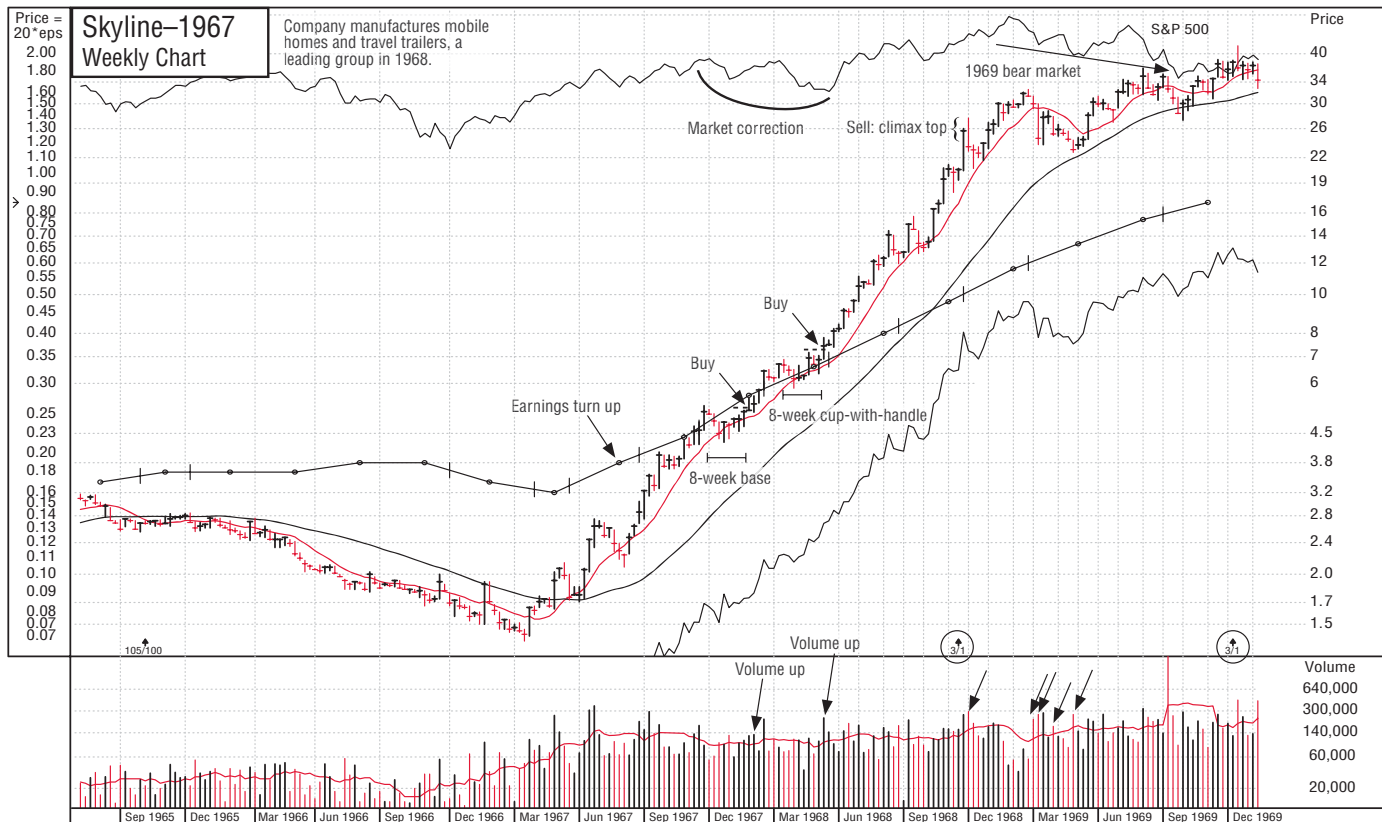
Loews increased 1025% in 101 weeks.

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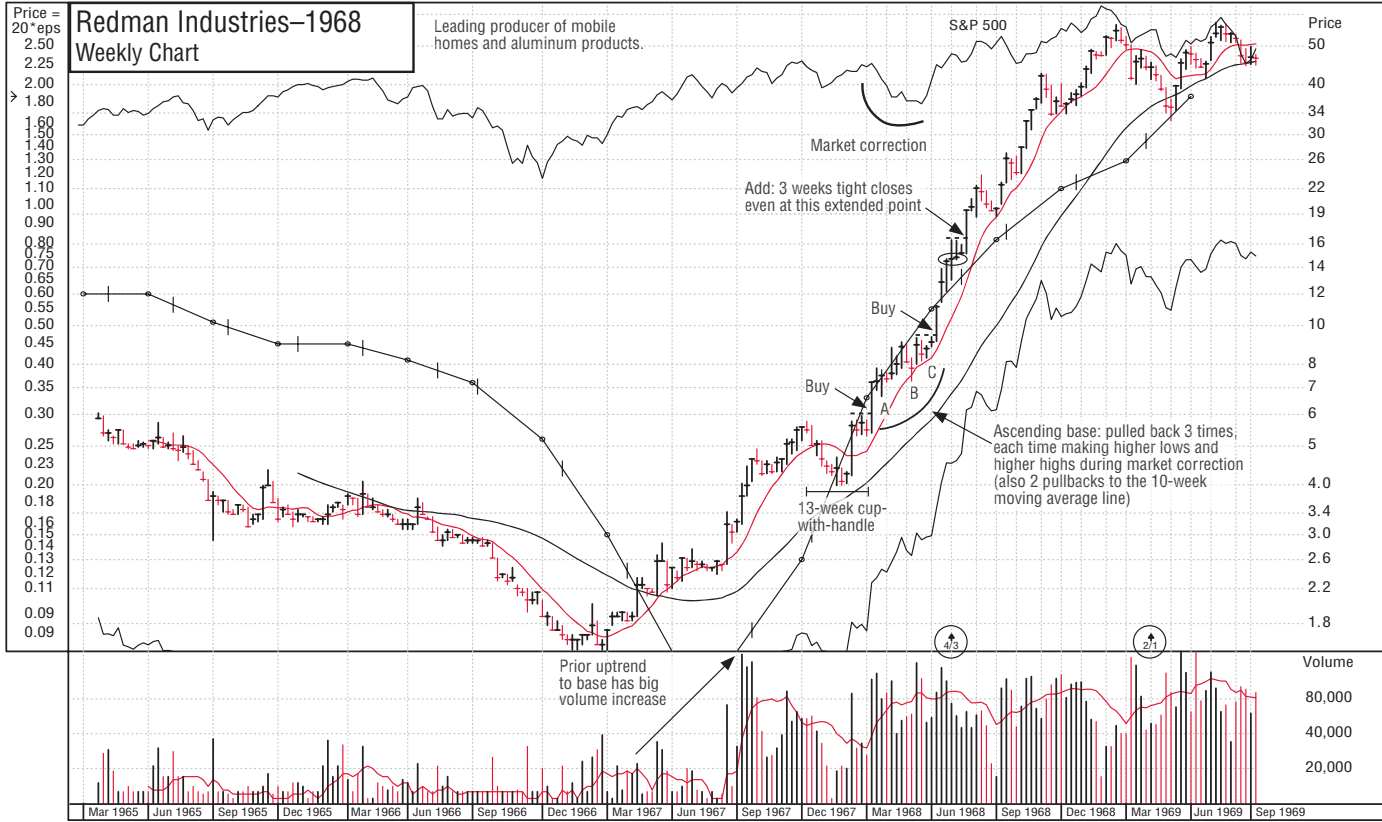
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Mattel increased 441% in 66 weeks.



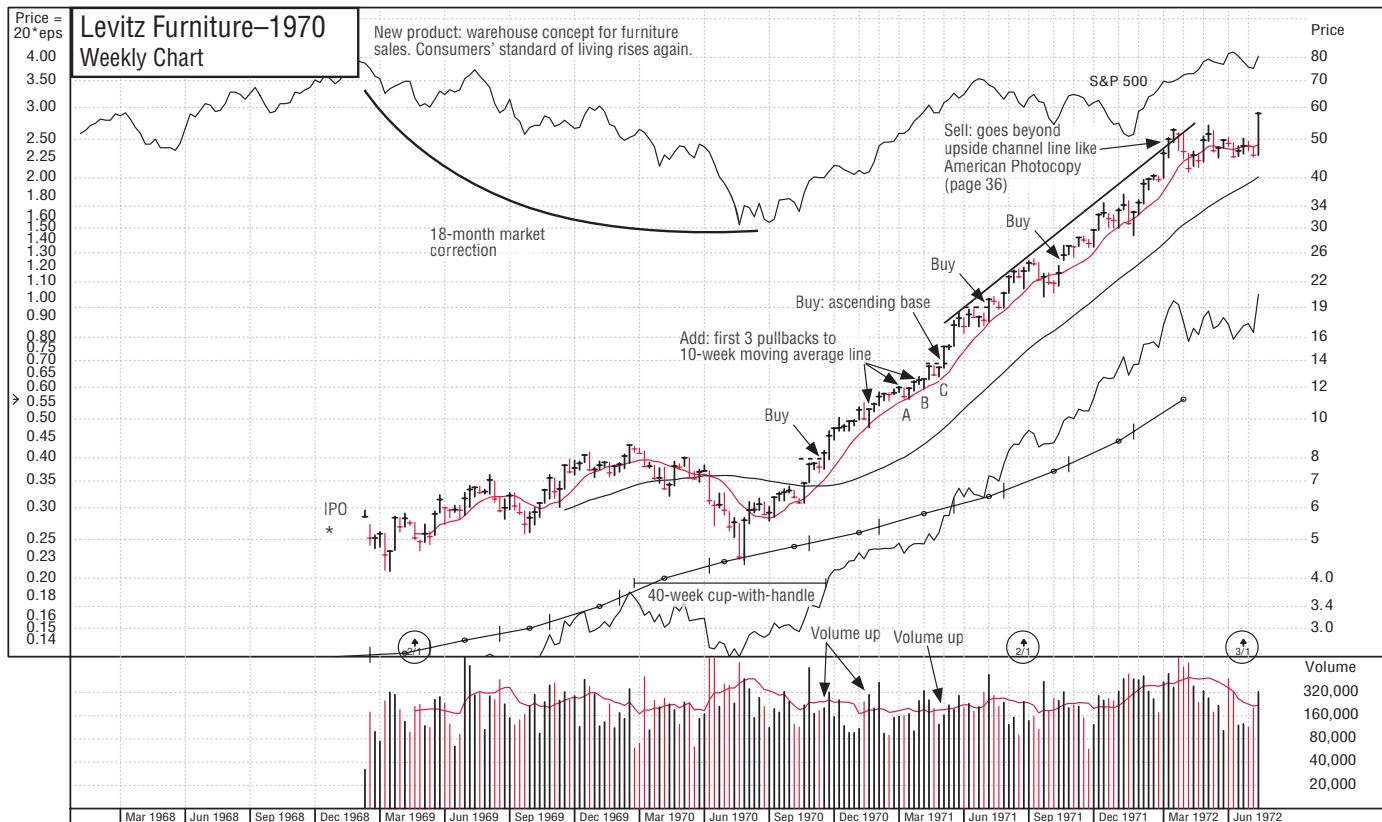
Skyline increased 715% in 98 weeks.

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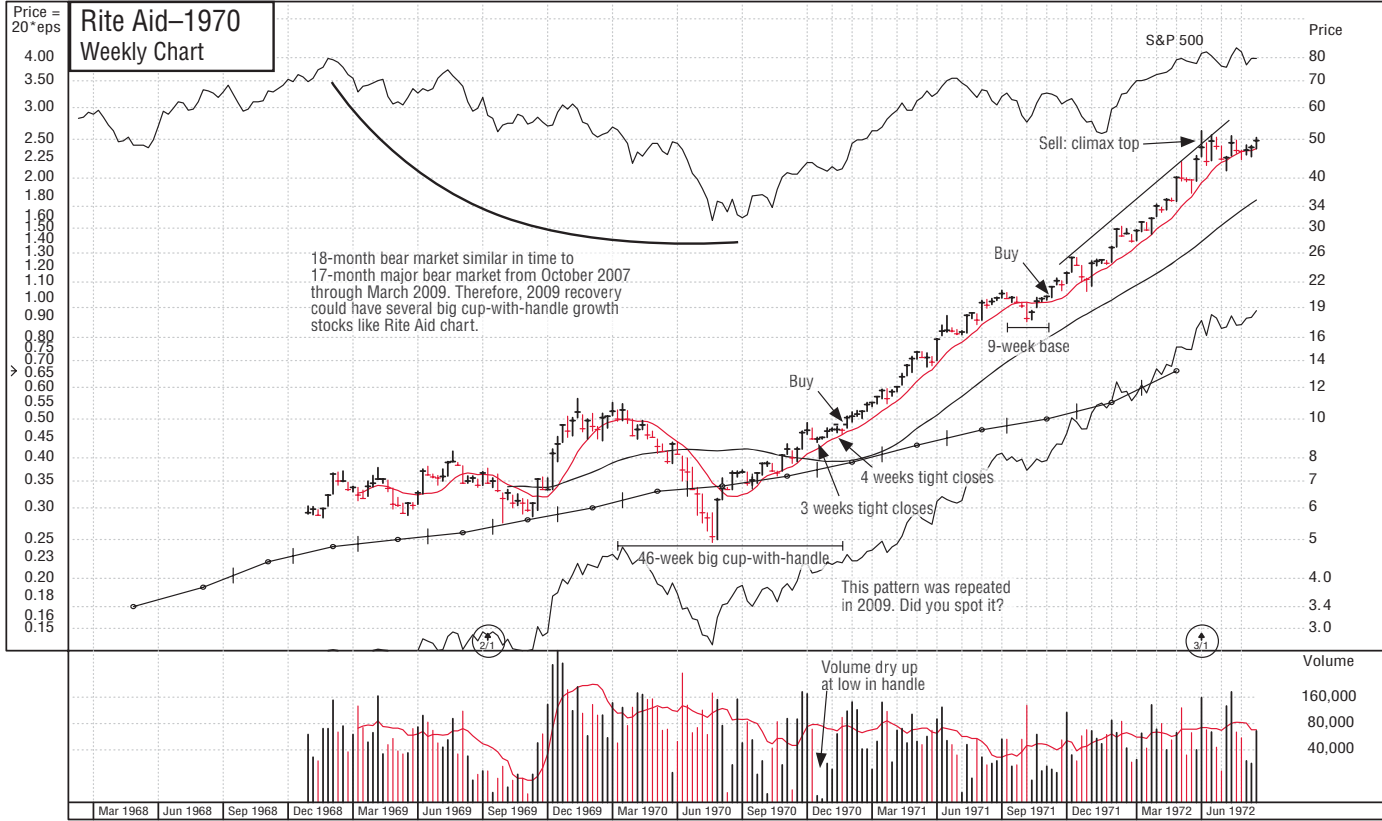


Redman Industries increased 683% in 49 weeks.

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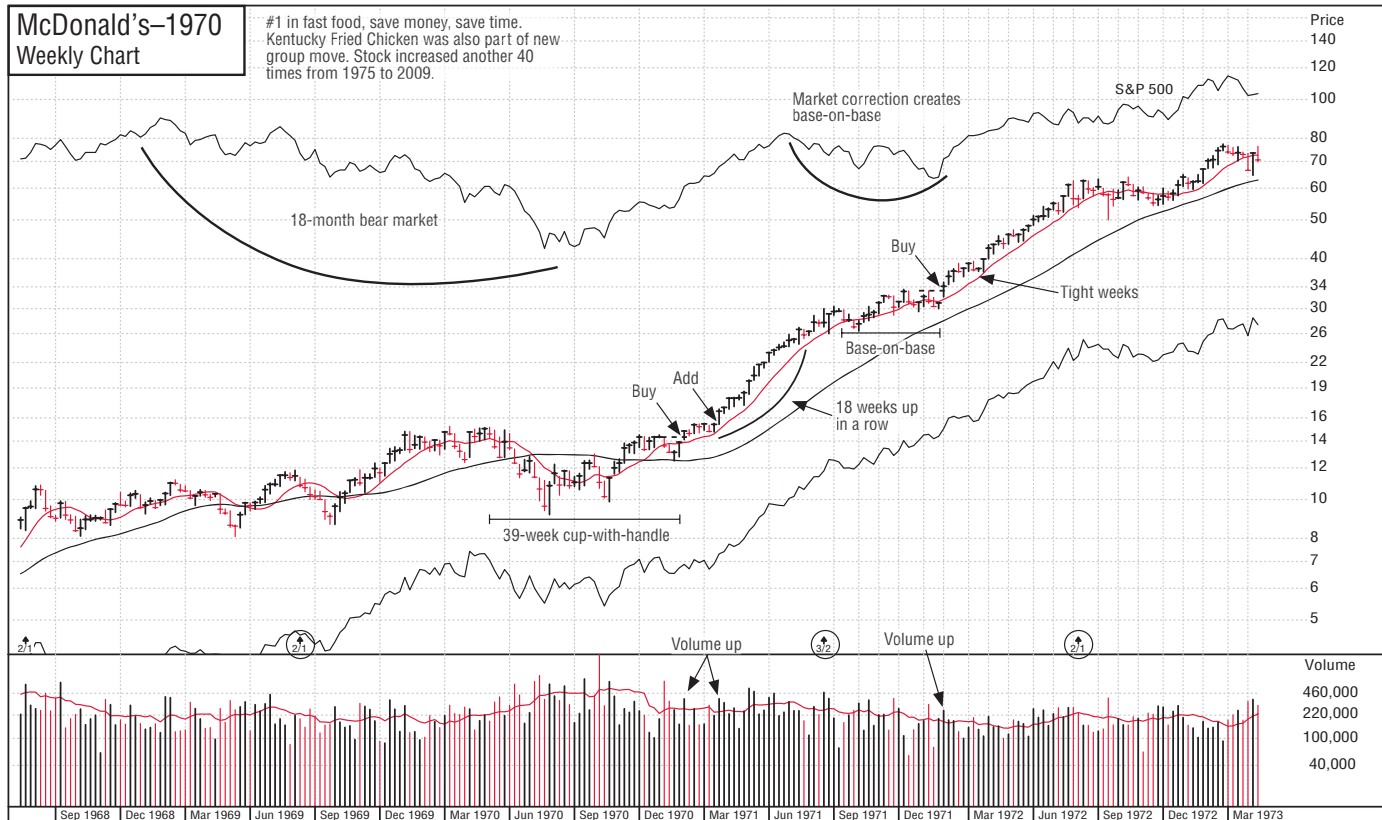
Levitz Furniture increased 608% in 87 weeks.



Rite Aid increased 421% in 71 weeks.

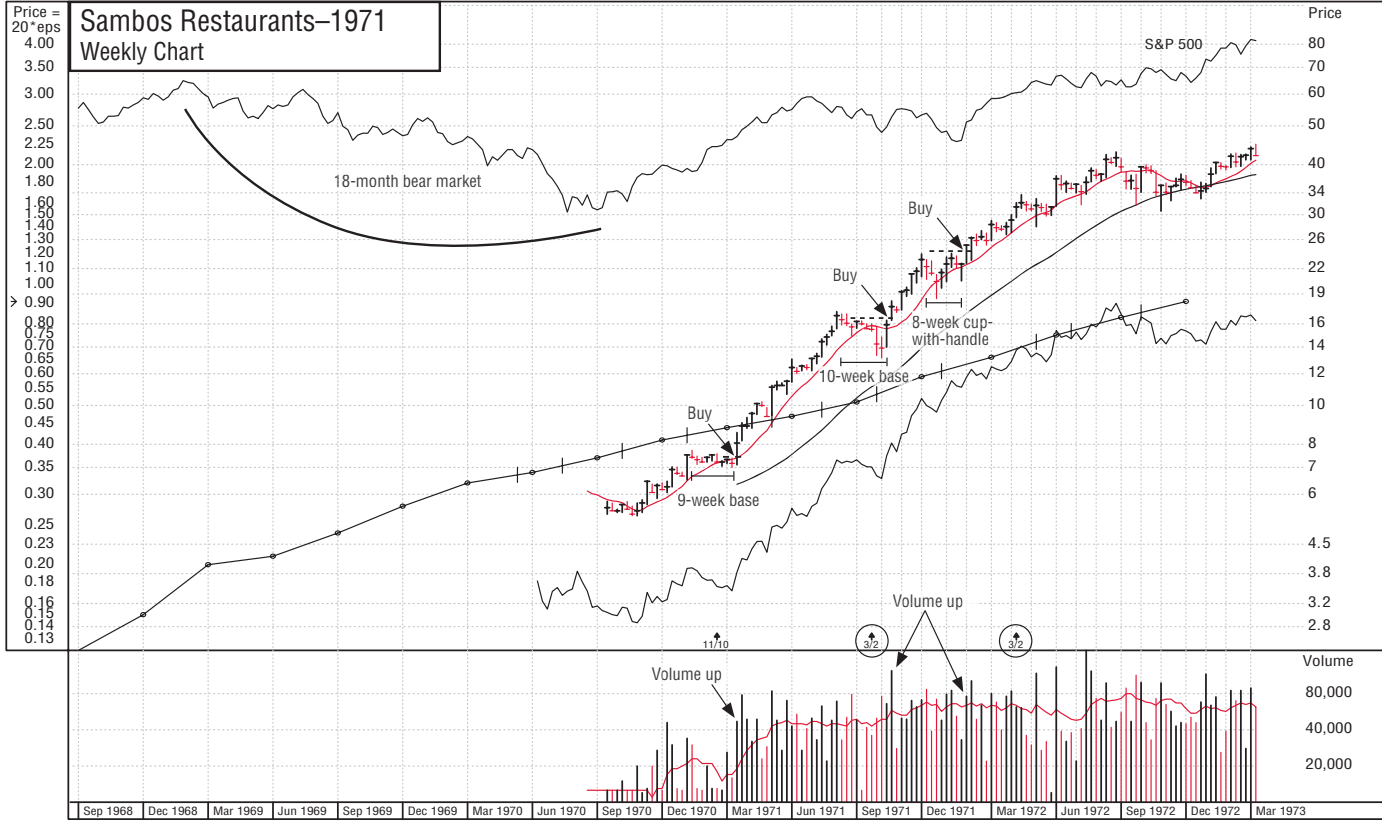
McDonald's-1970 Weekly Chart

#1 in fast food, save money, save time.
Kentucky Fried Chicken was also part of new
group move. Stock increased another 40
times from 1975 to 2009.

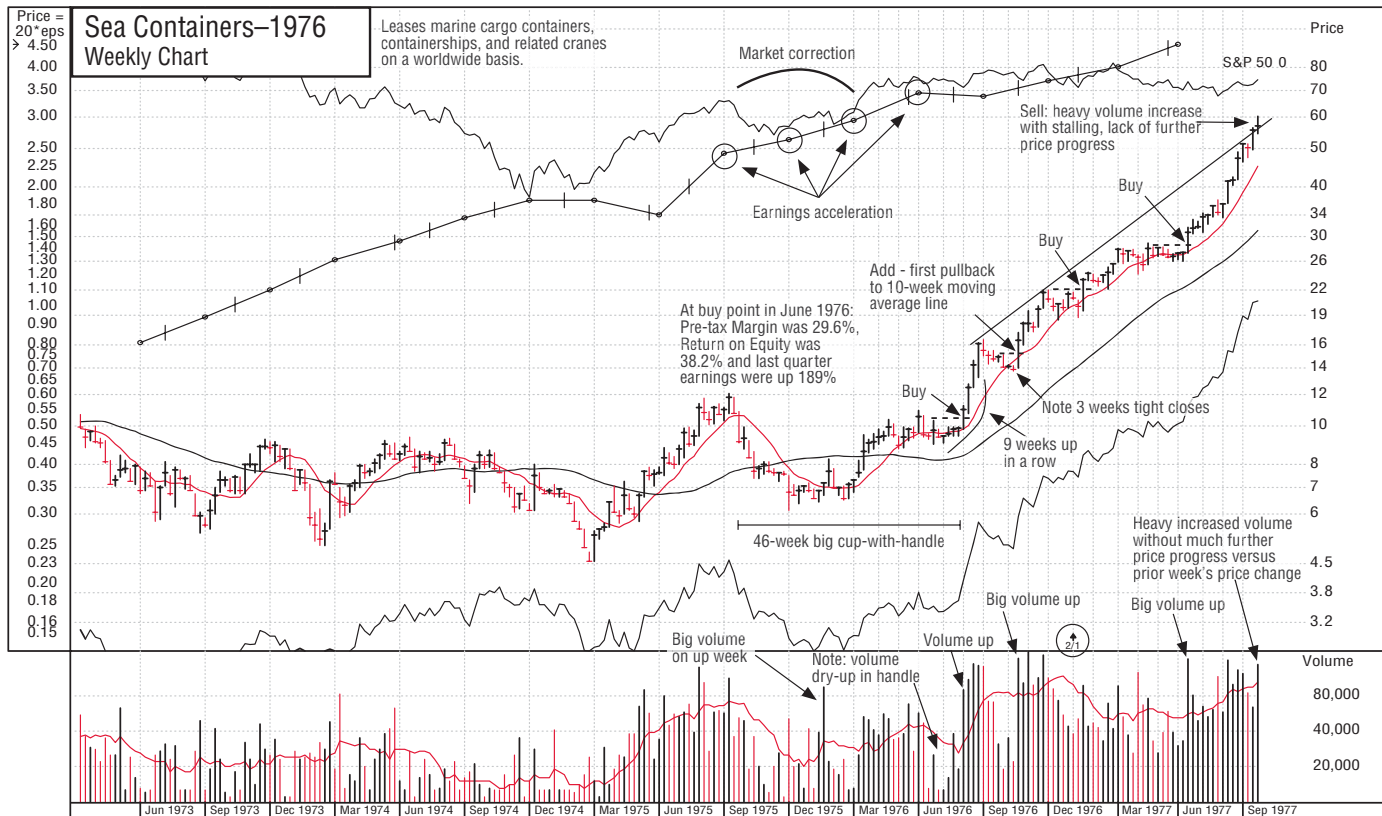


McDonald's increased 422% in 108 weeks.

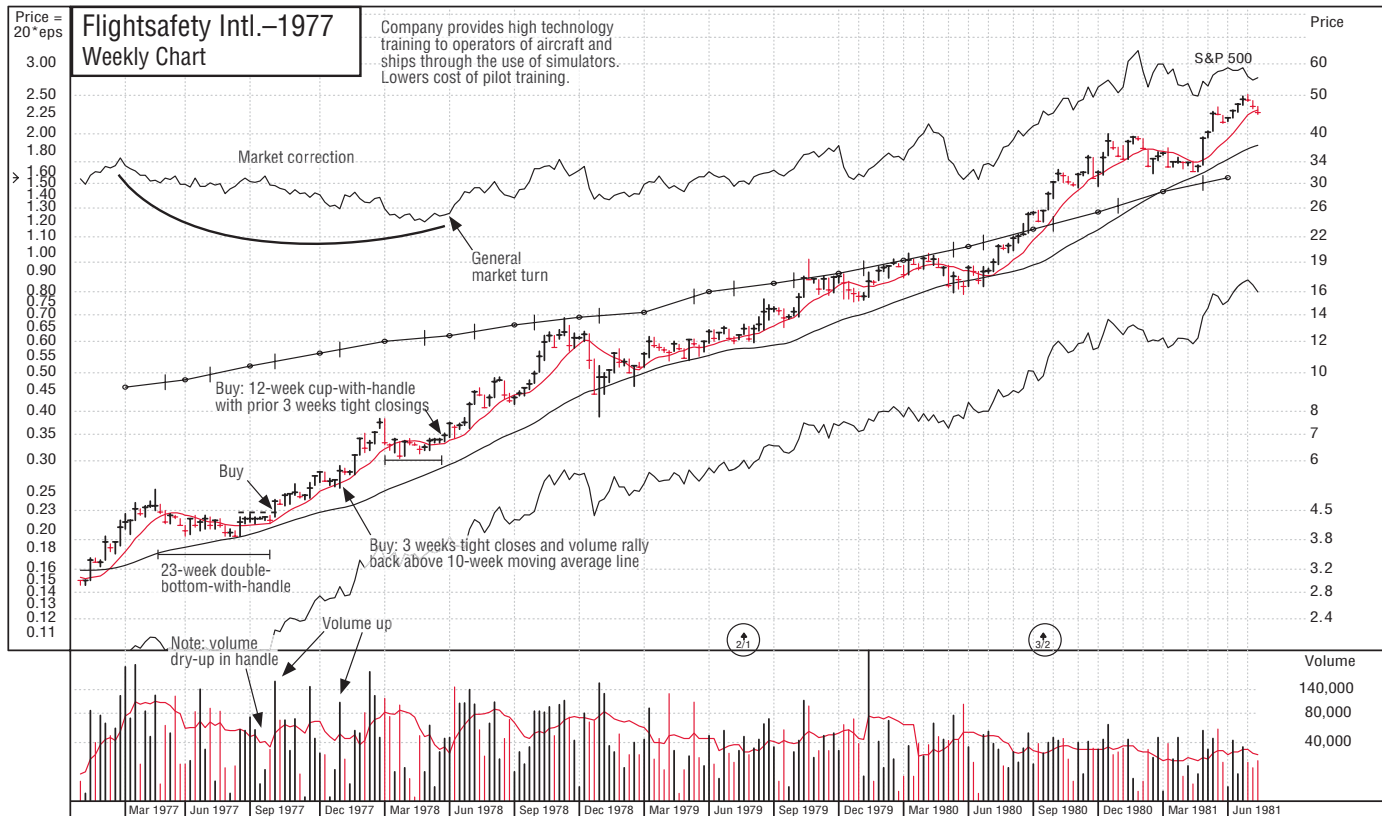
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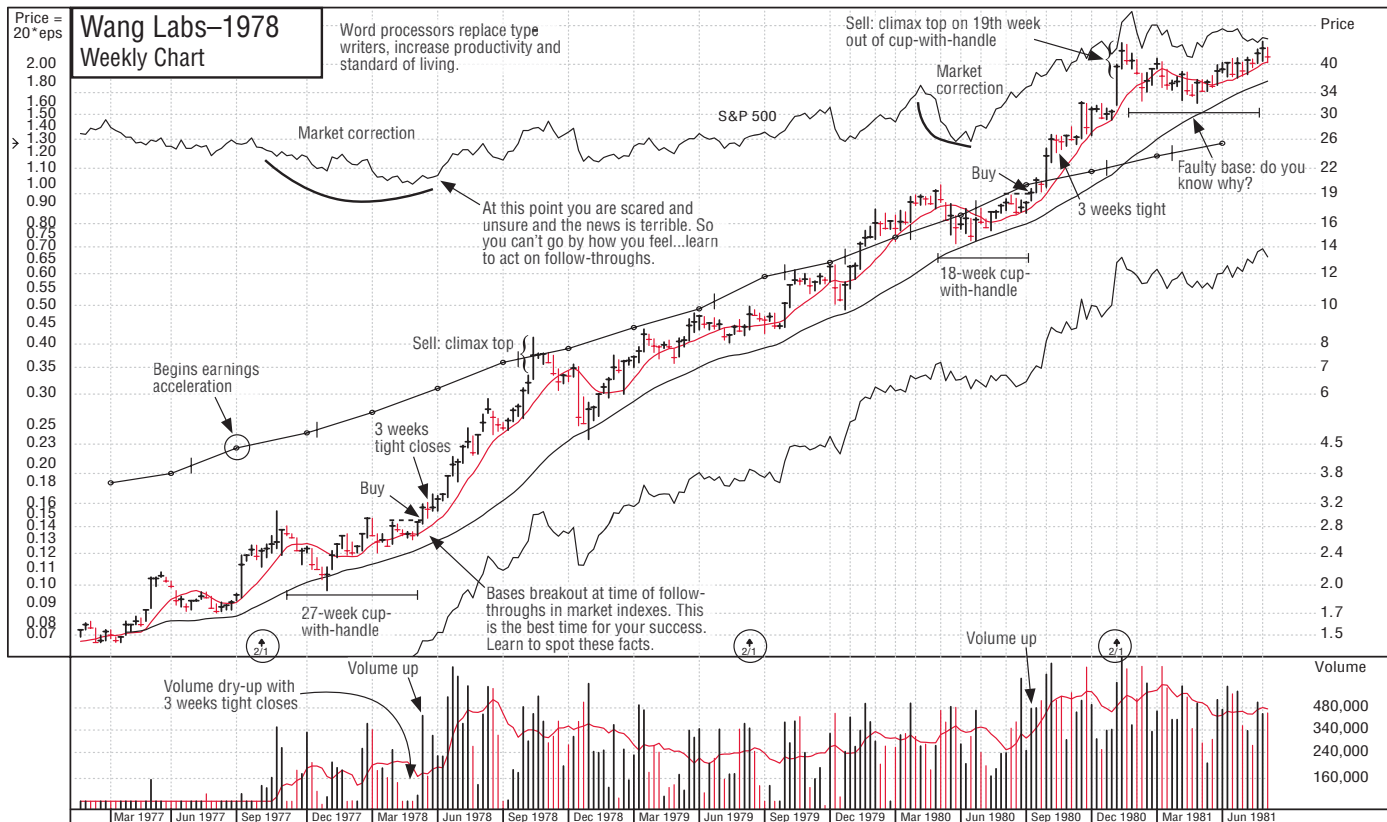
Sambos Restaurants increased 458% in 104 weeks.



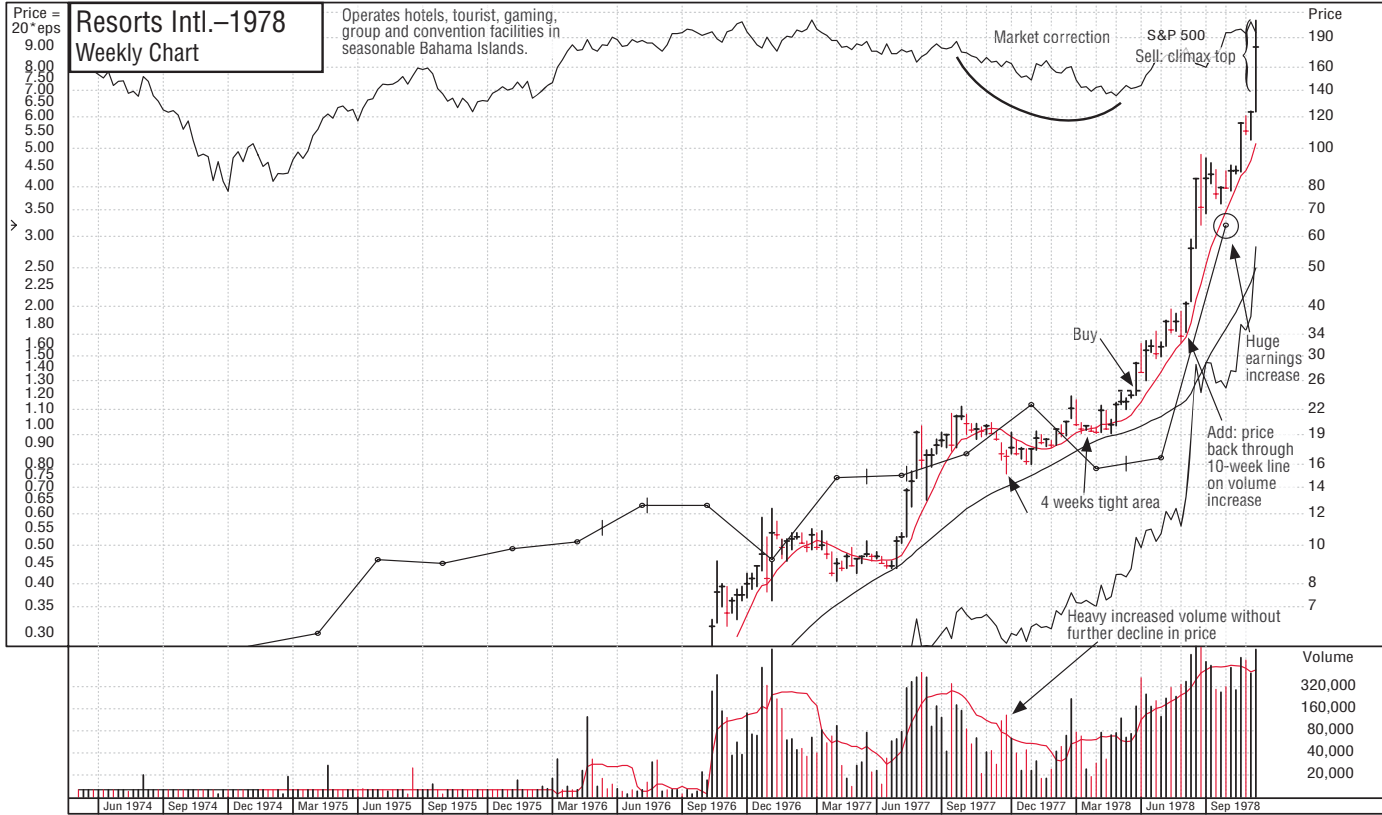
Sea Containers increased 448% in 59 weeks.



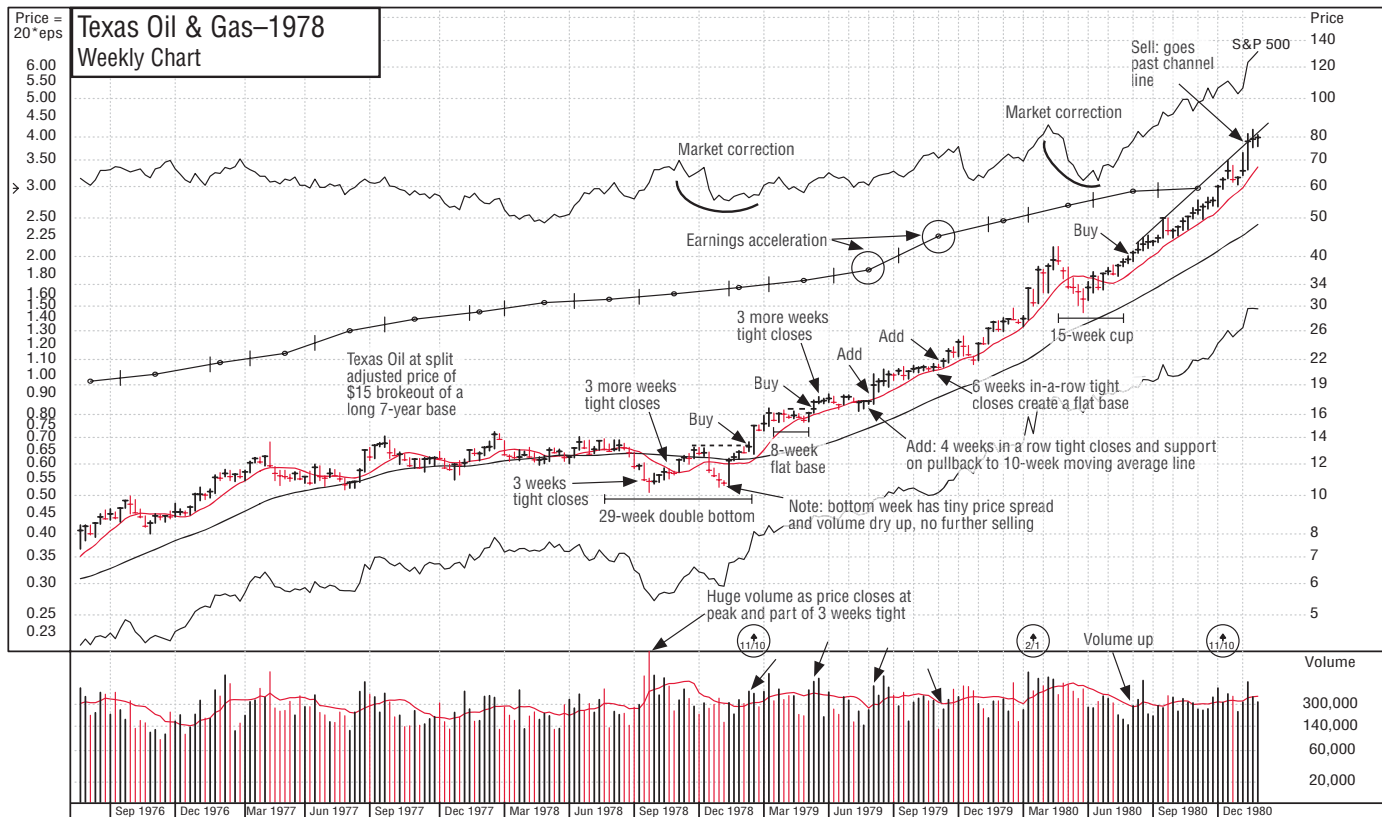
Flightsafety International increased 958% in 195 weeks.



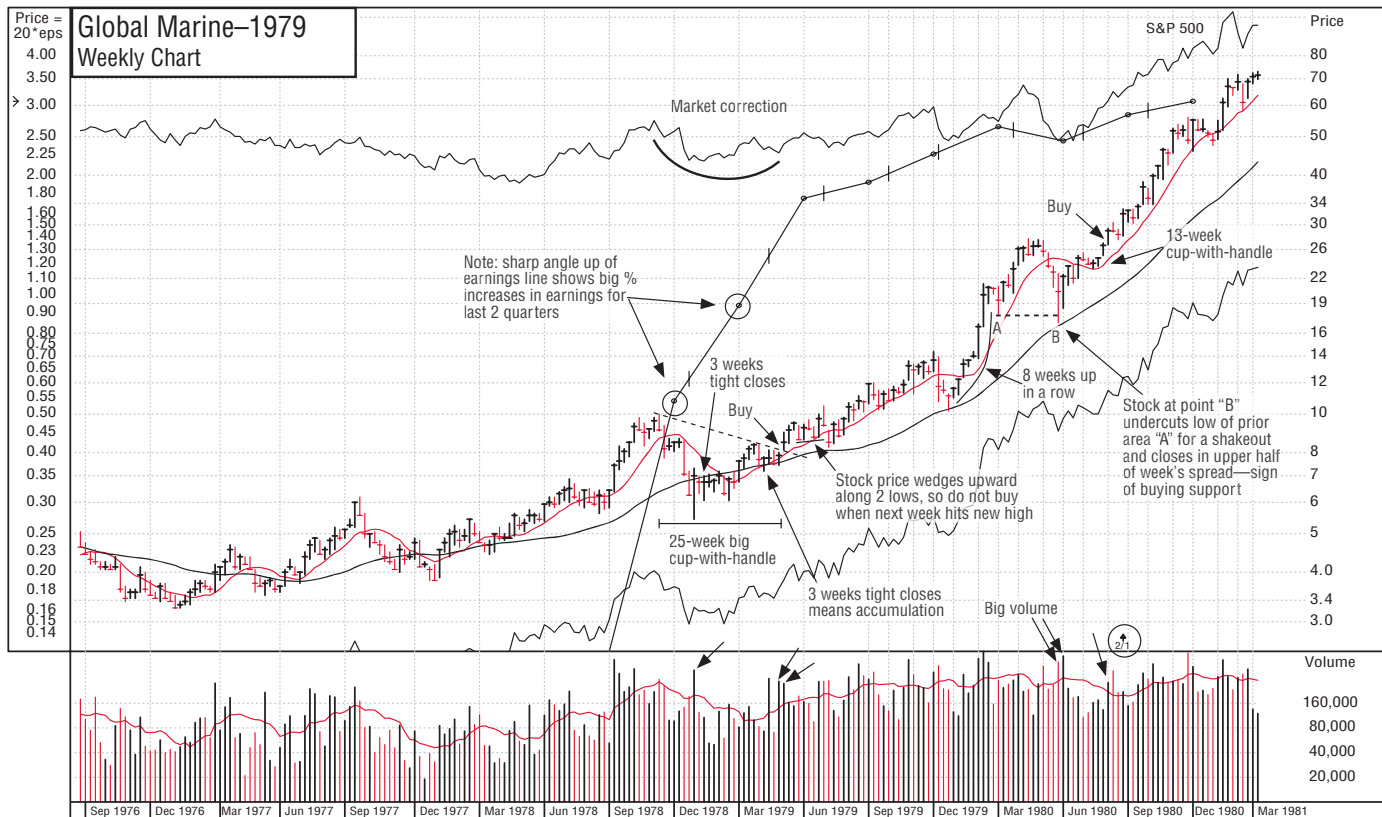
Wang Laboratories increased 1348% in 139 weeks.



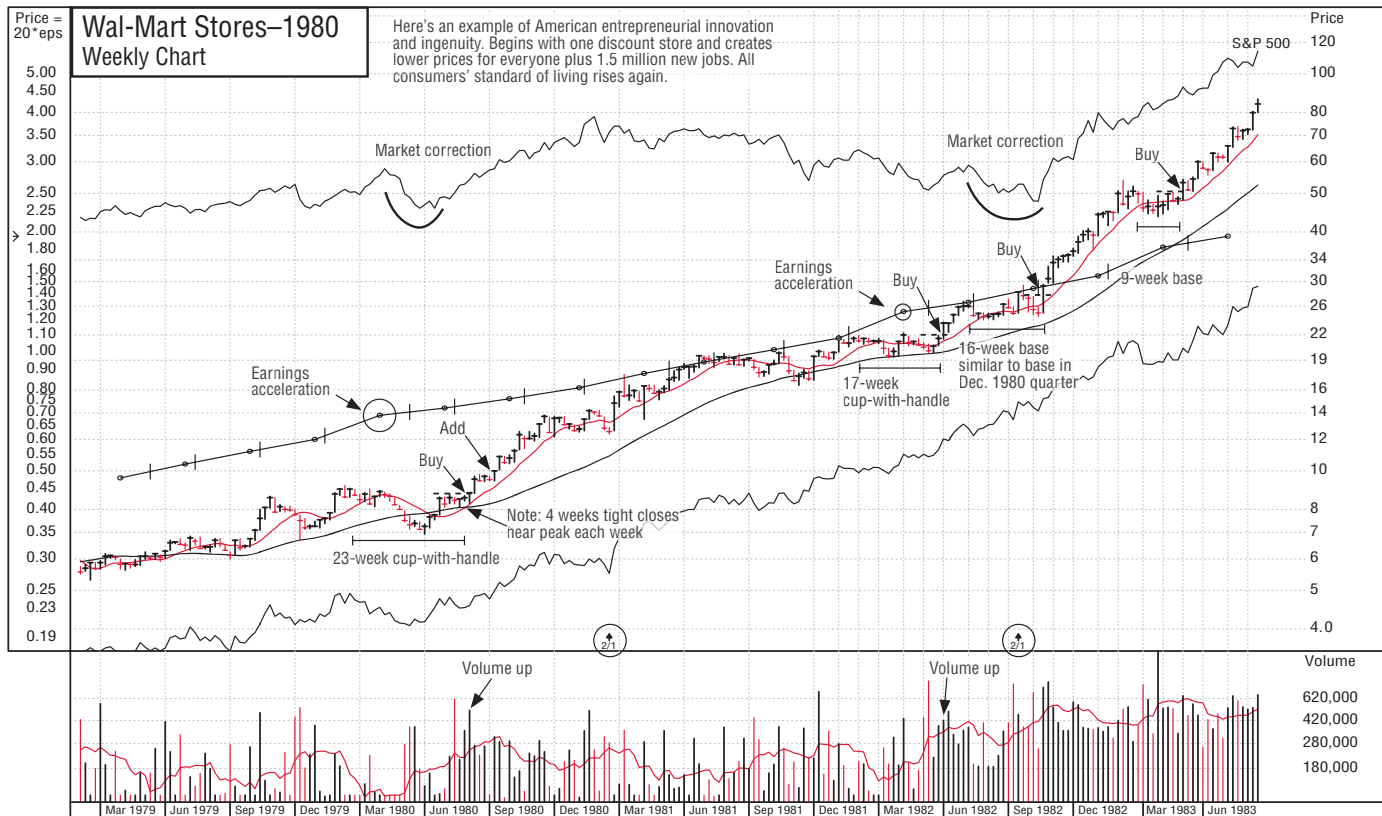
Resorts International increased 630% in 24 weeks.



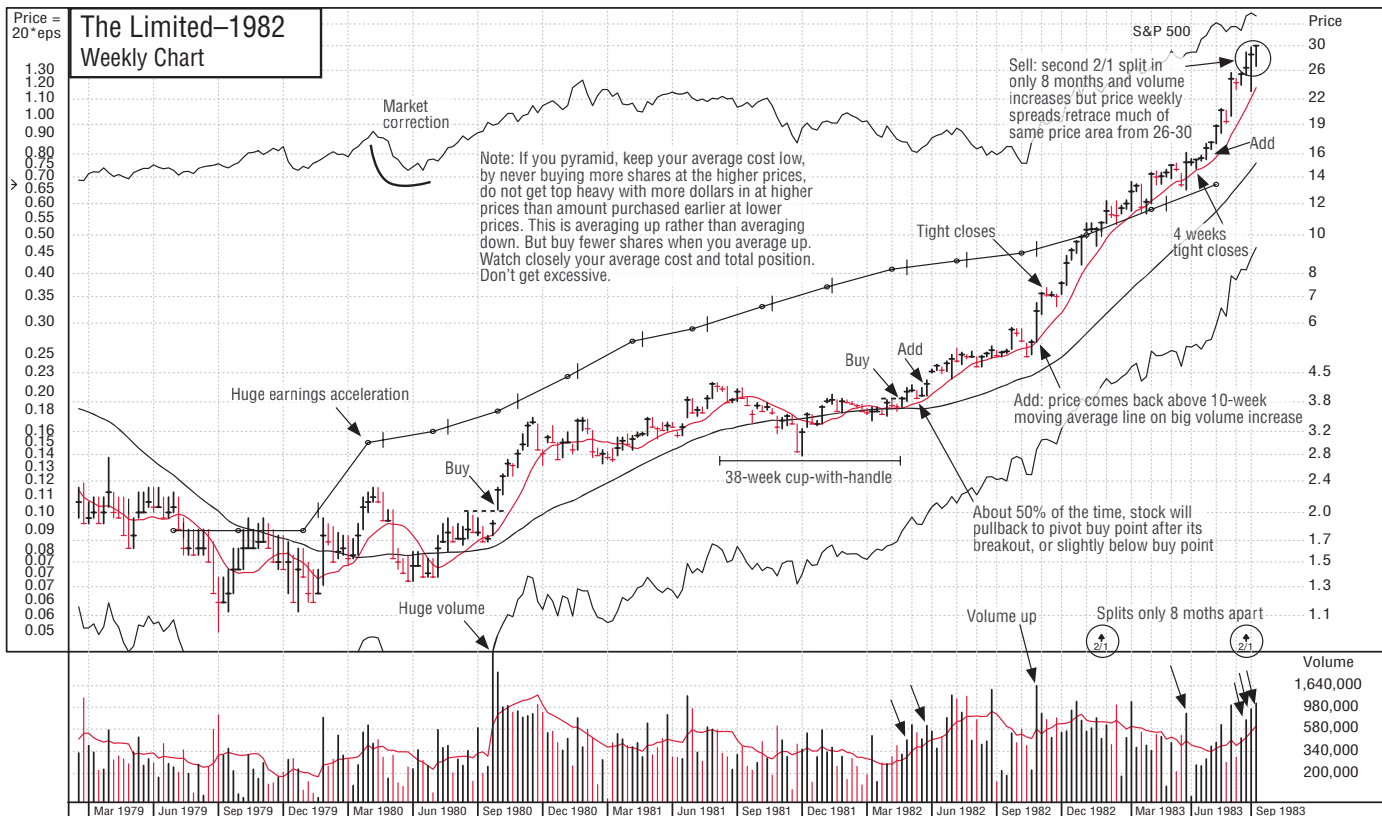
Texas Oil & Gas increased 529% in 101 weeks.



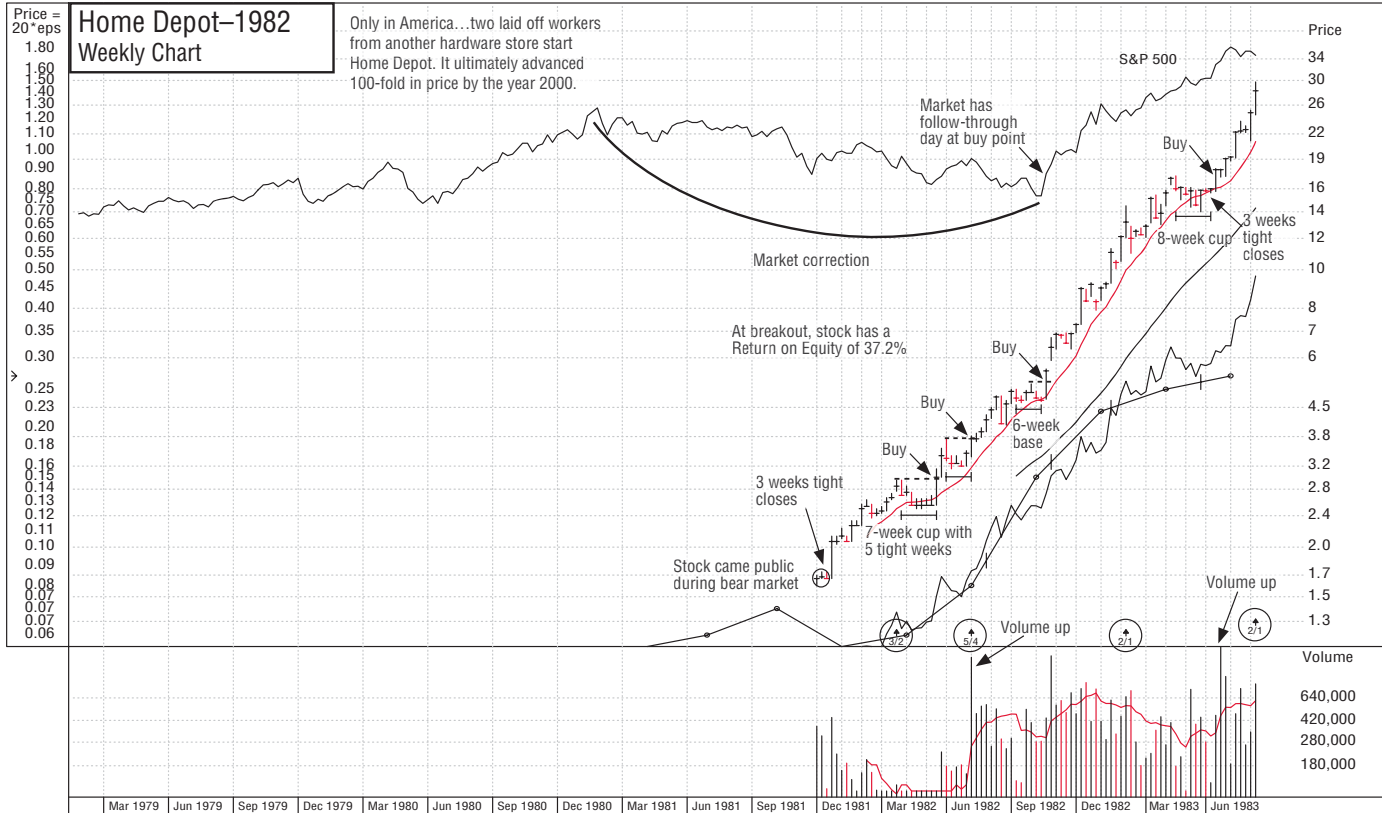
Global Marine increased 752% in 94 weeks.



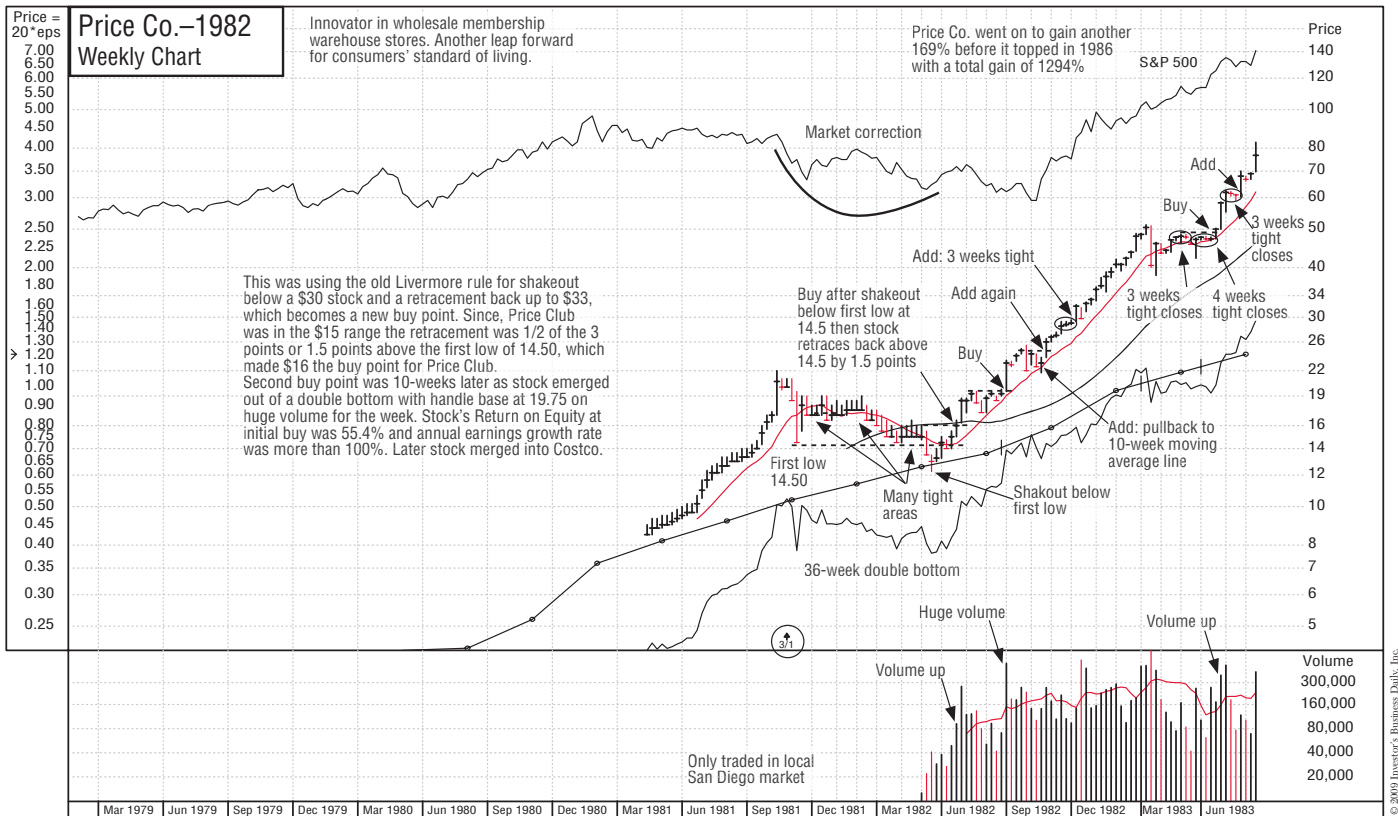
Wal-Mart Stores increased 882% in 158 weeks.



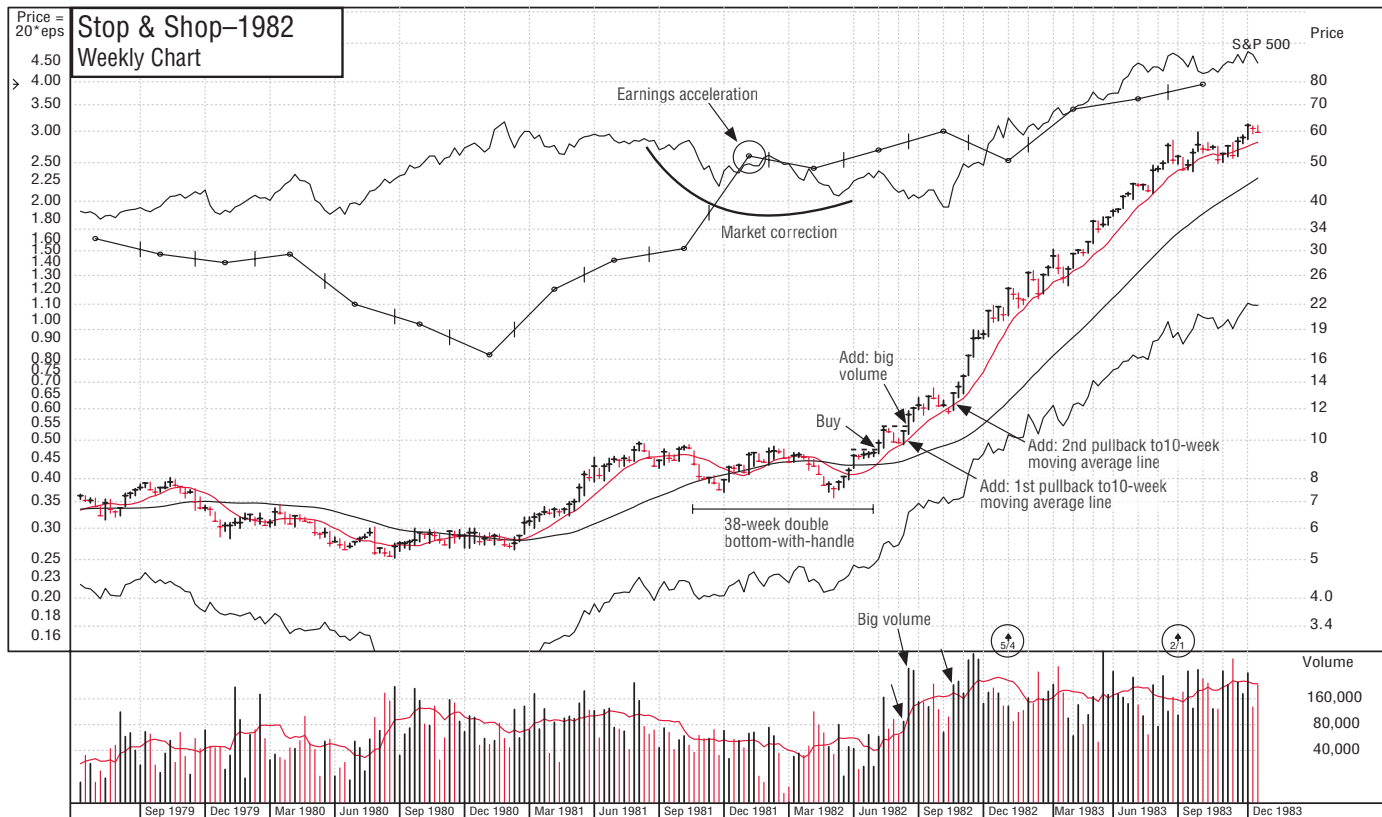
The Limited increased 673% in 71 weeks.



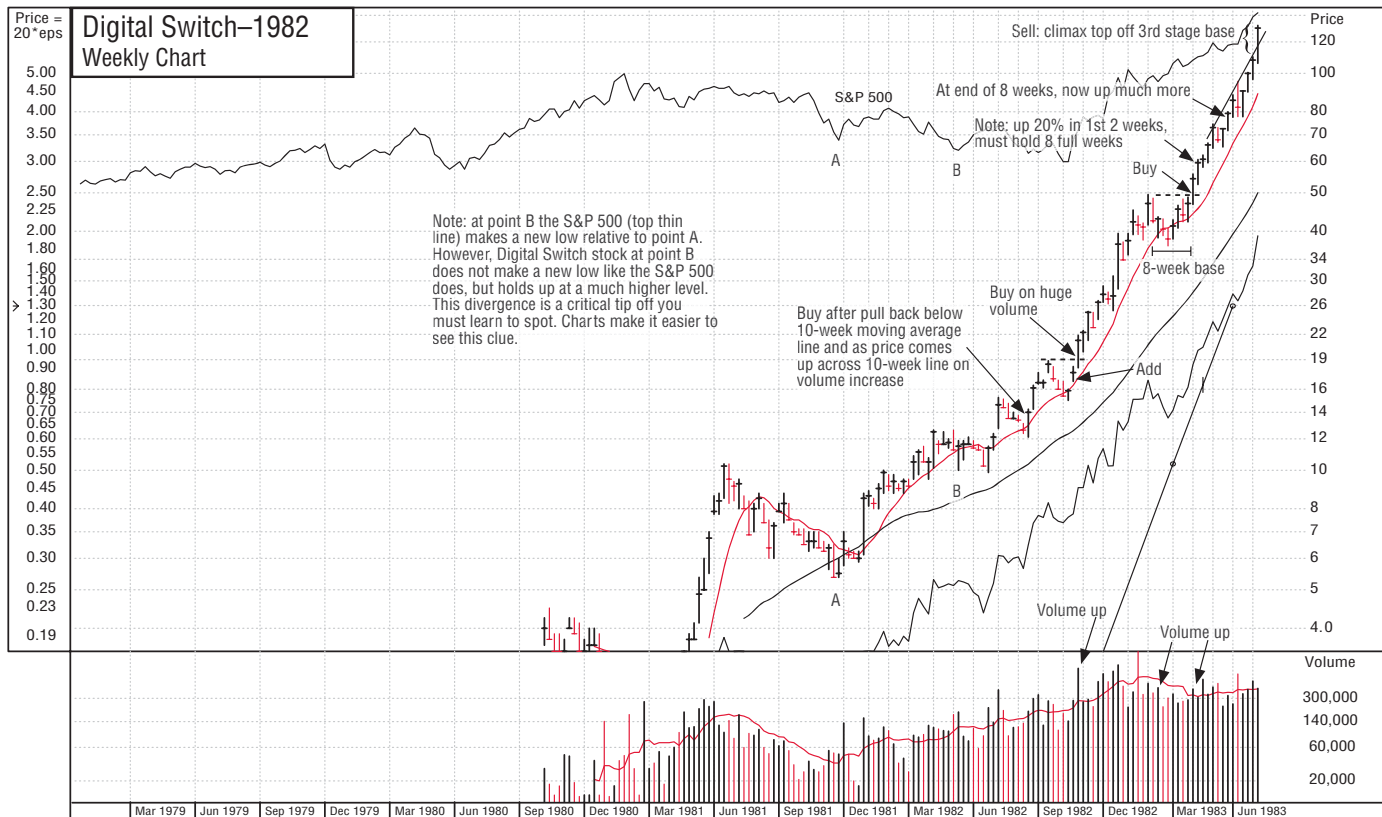
Home Depot increased 892% in 64 weeks.



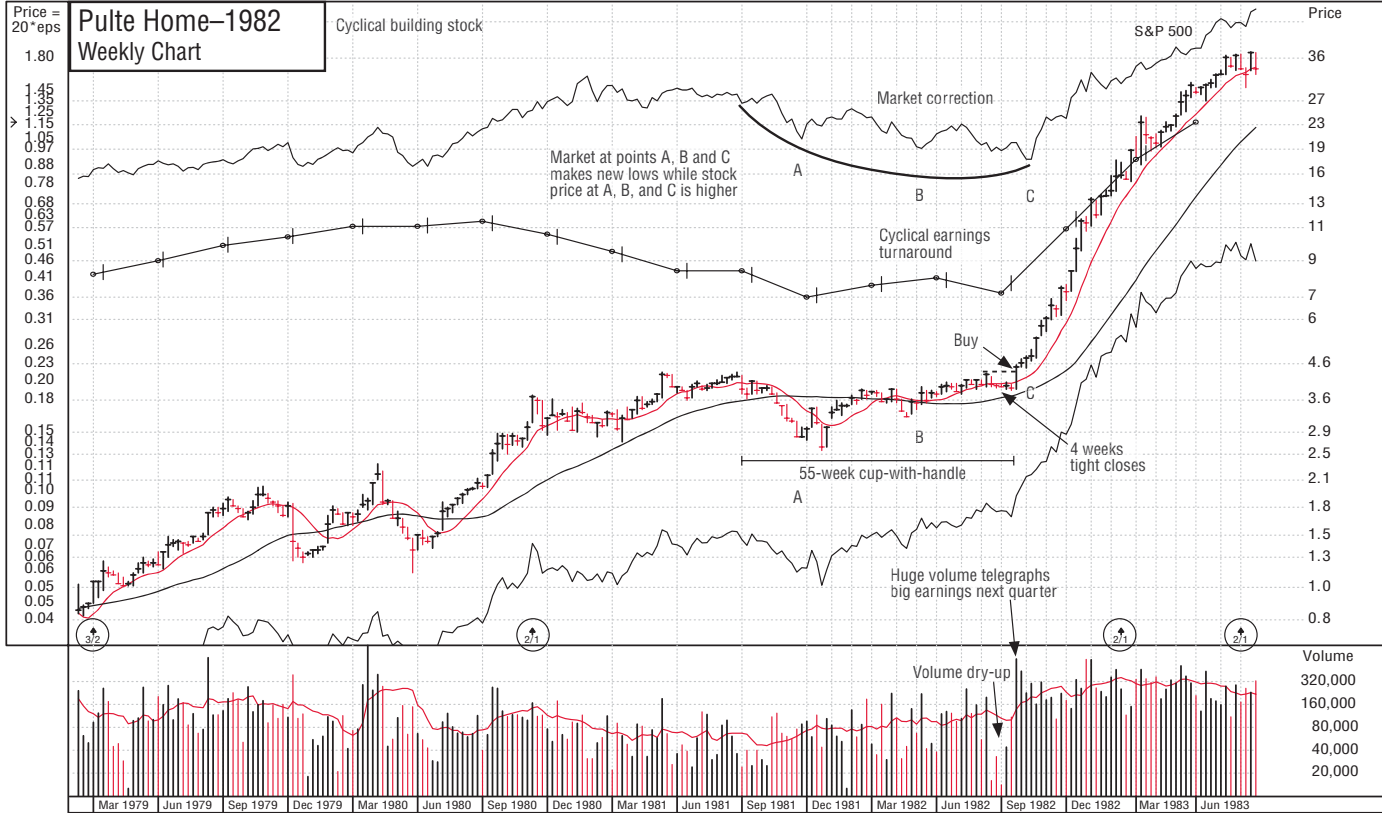
Price Company increased 417% in 60 weeks.



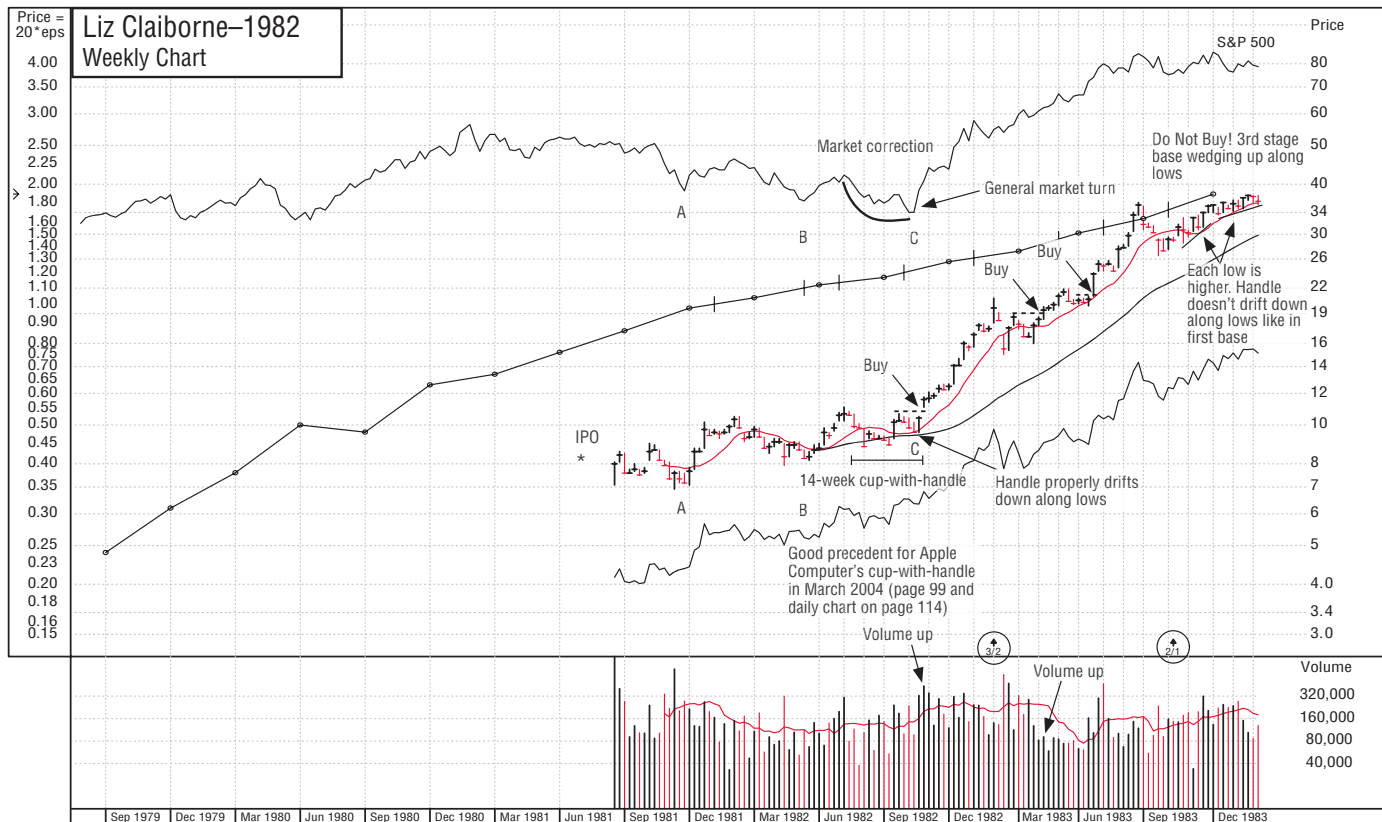
Stop & Shop increased 536% in 74 weeks.



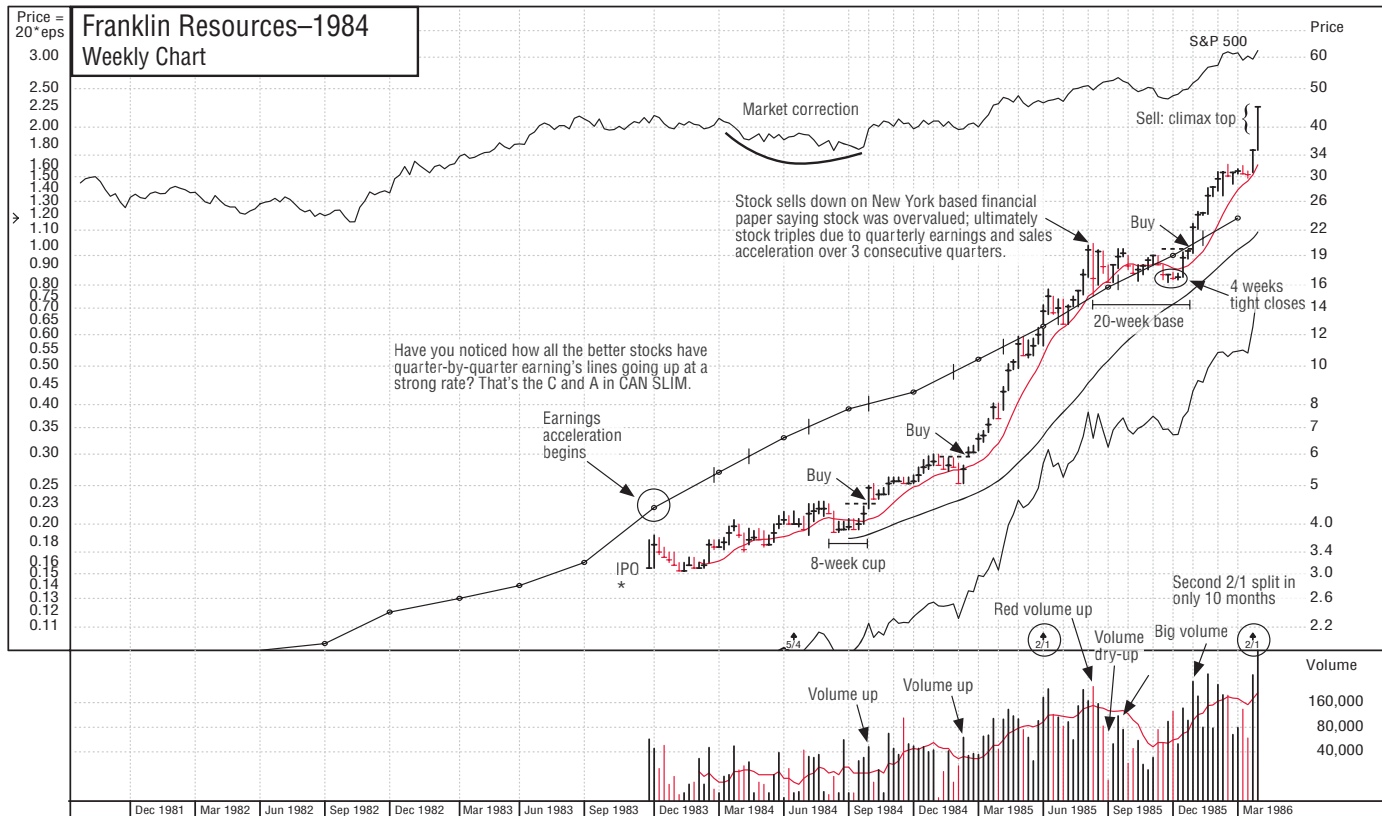
Digital Switch increased 843% in 46 weeks.



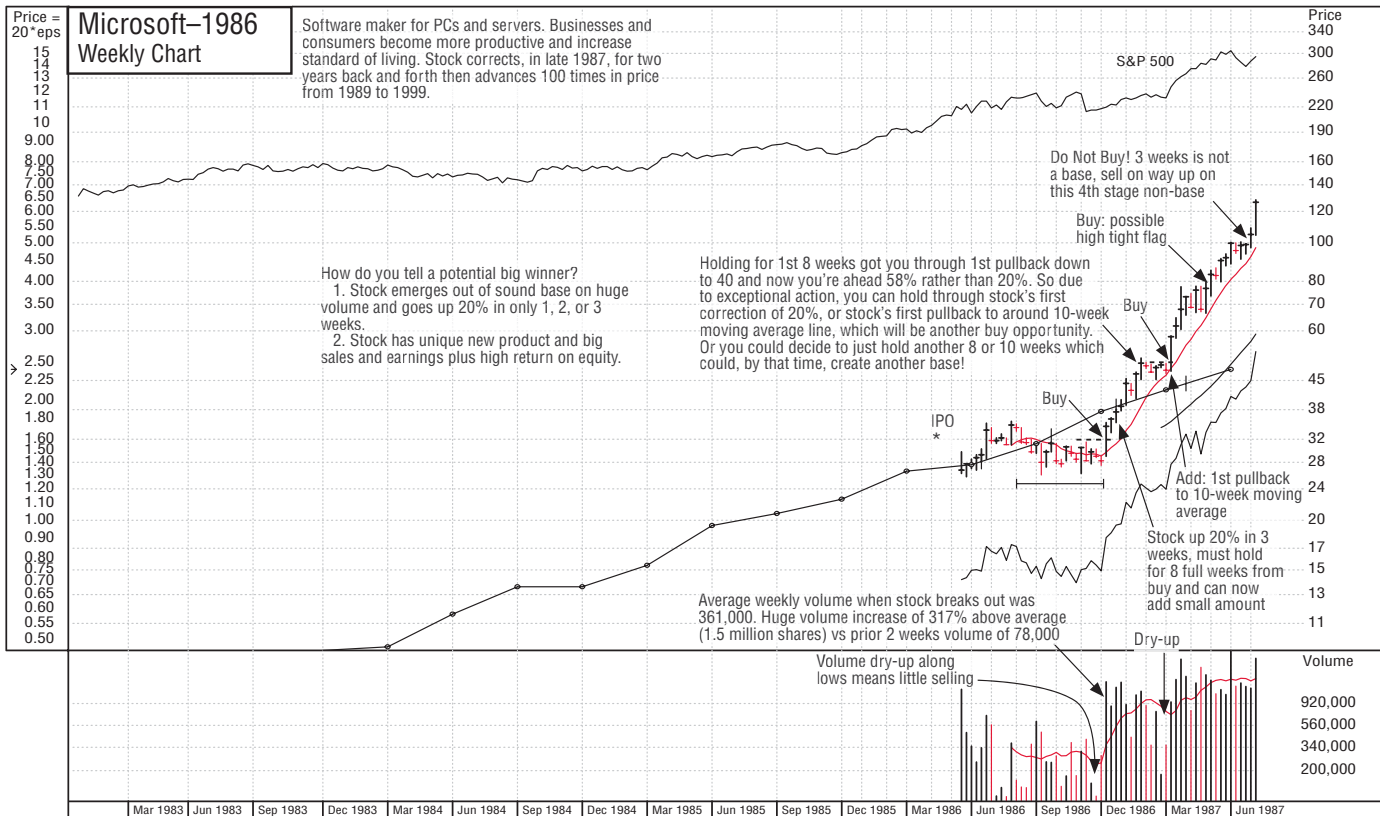
Pulte Home increased 733% in 47 weeks.



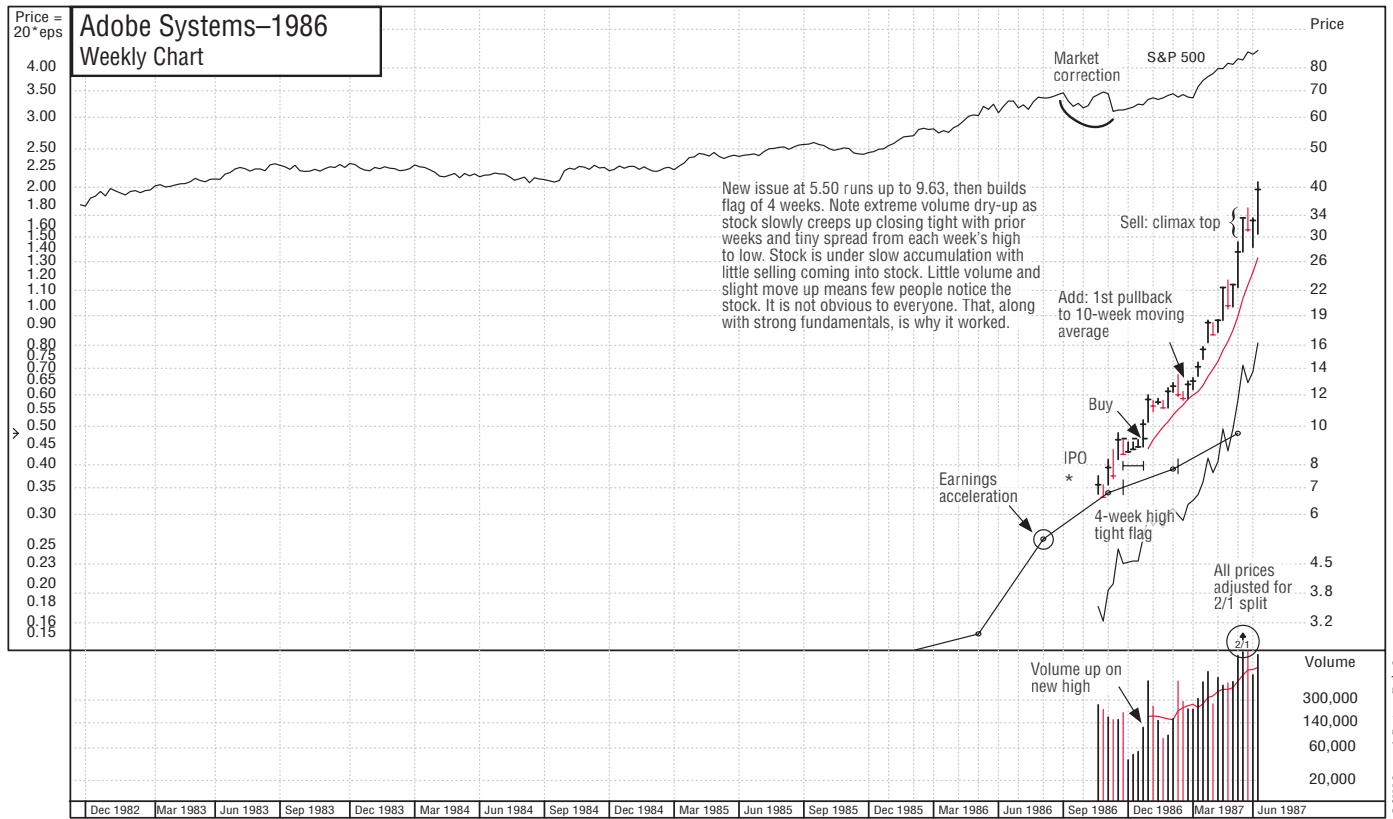
Liz Claiborne increased 211% in 43 weeks.



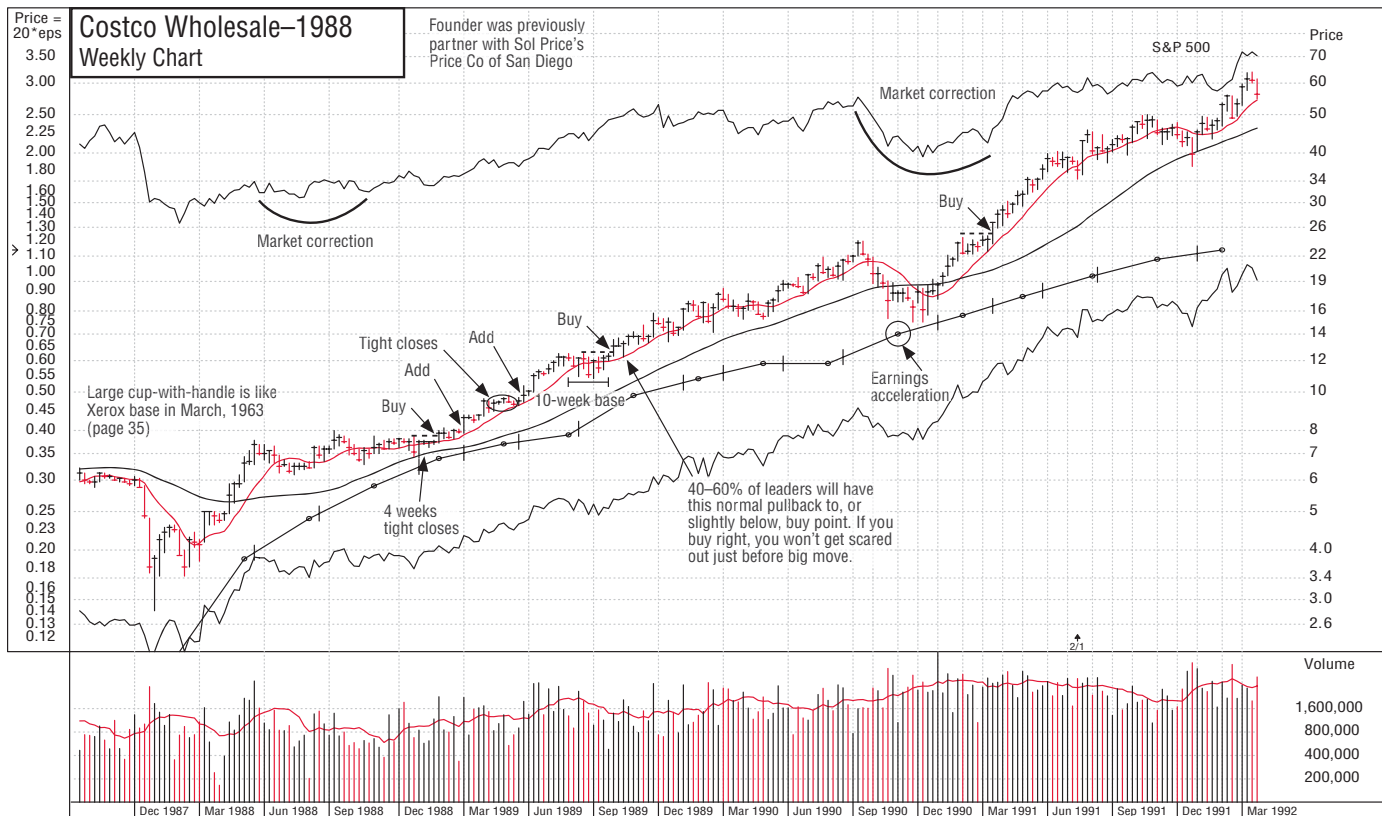
Franklin Resources increased 811% in 78 weeks.



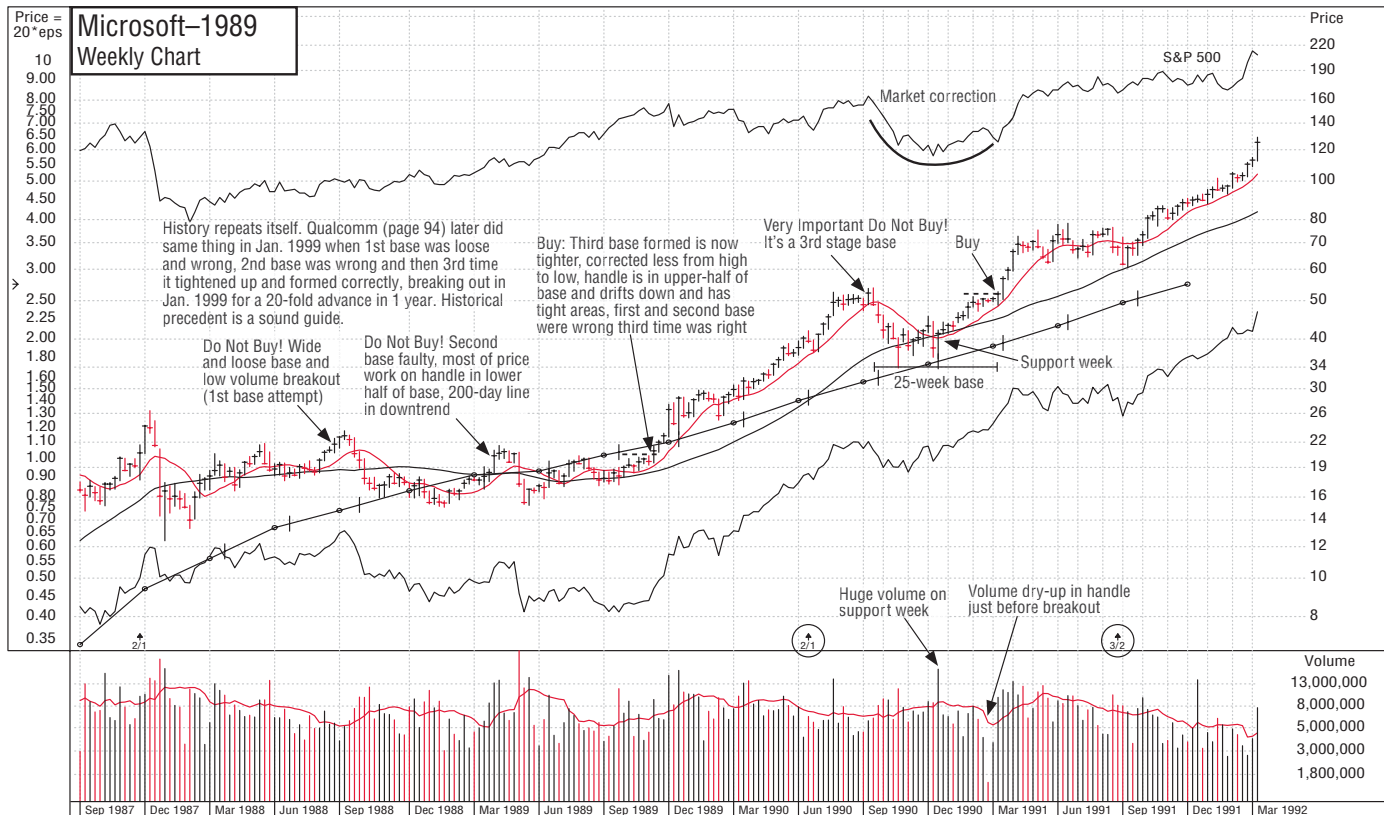
Microsoft increased 272% in 30 weeks.



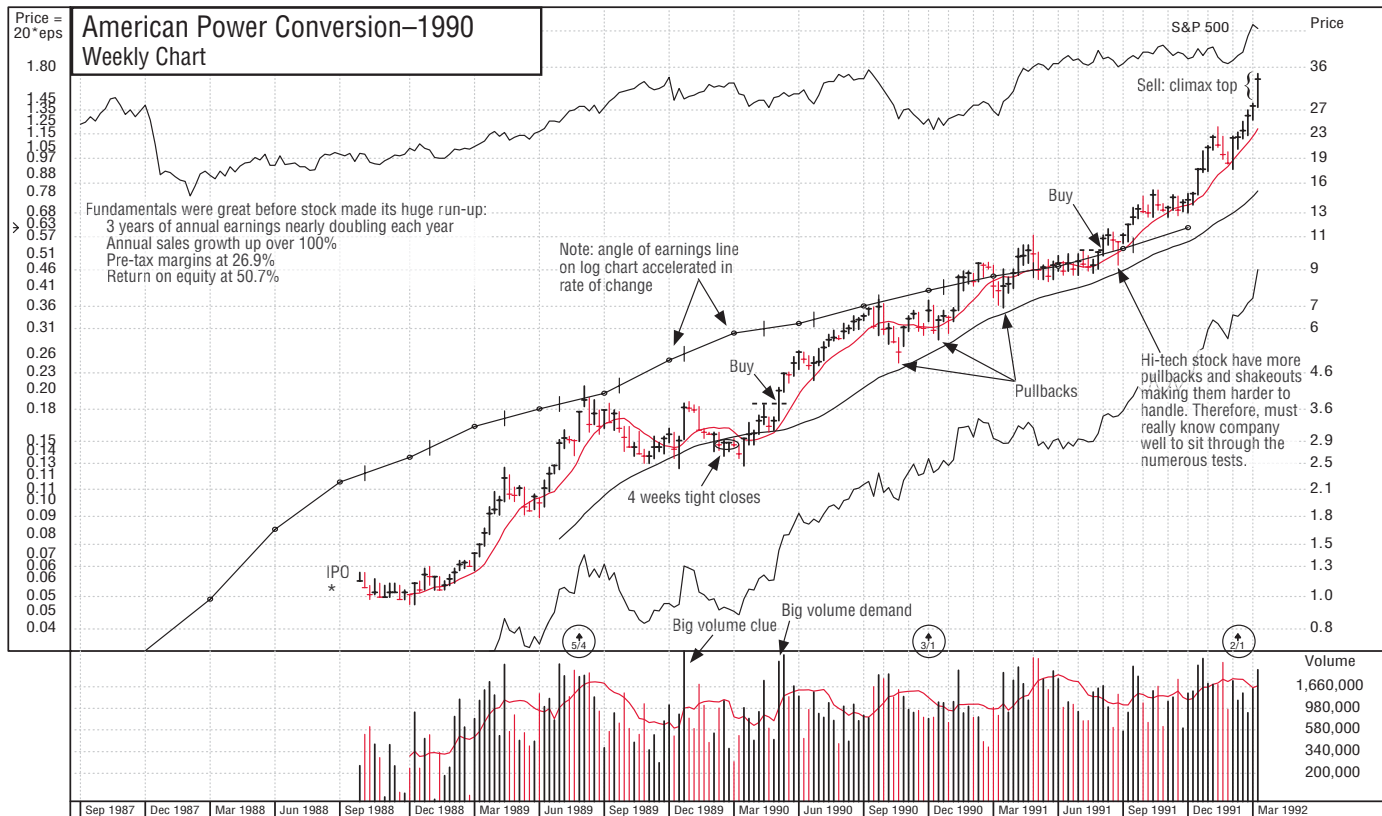
Adobe Systems increased 307% in 23 weeks.



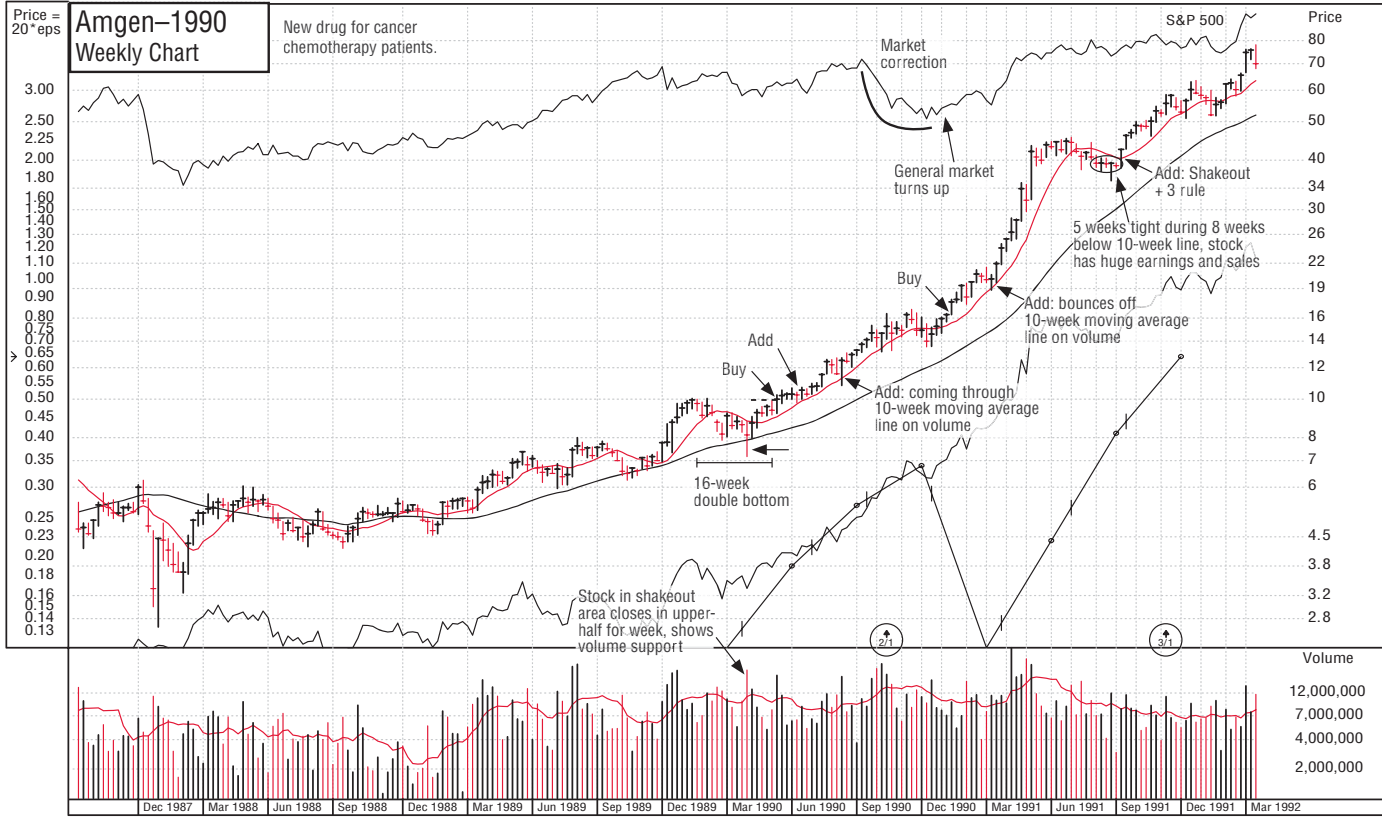
Costco Wholesale increased 712% in 163 weeks.



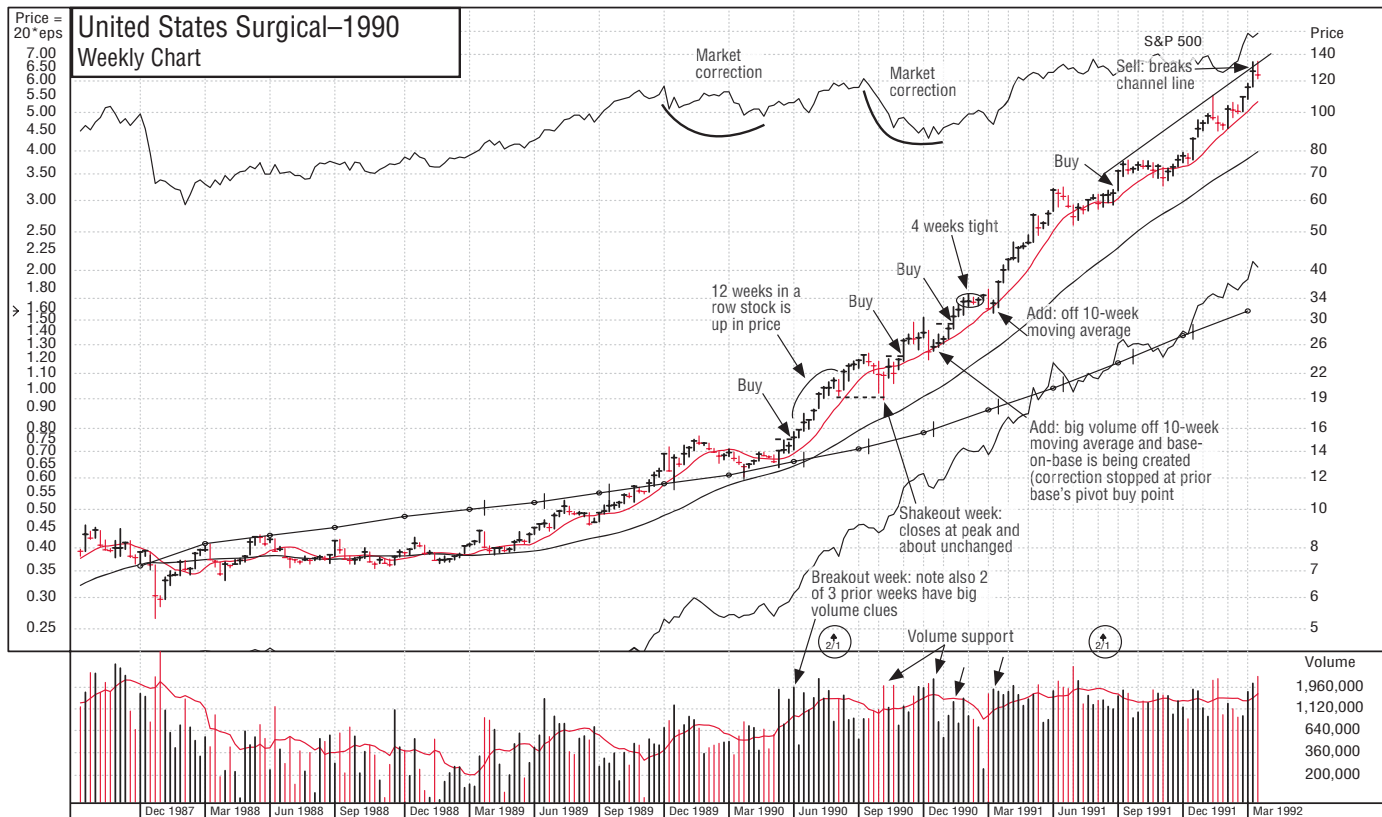
Microsoft increased 517% in 121 weeks.



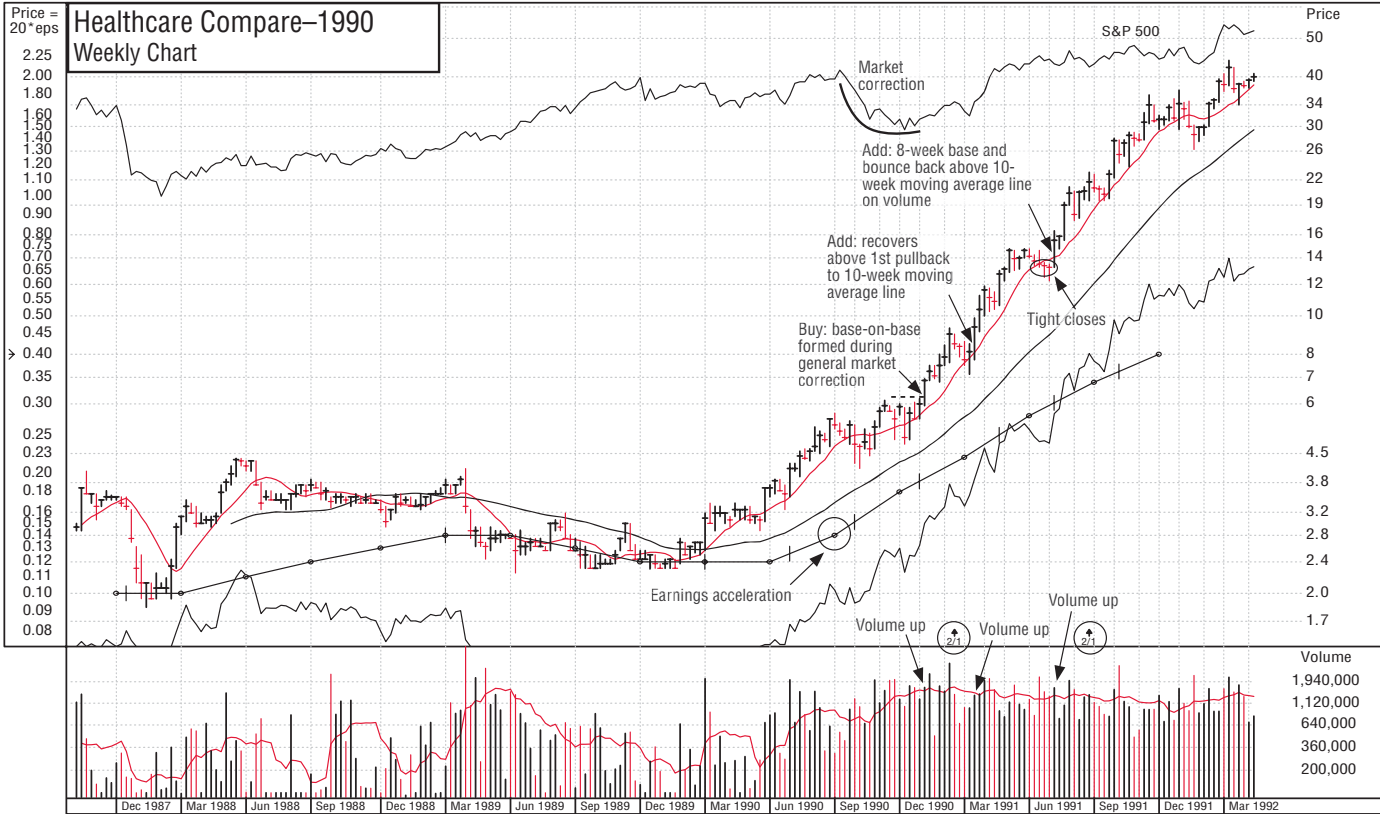
American Power Conversion increased 745% in 96 weeks.



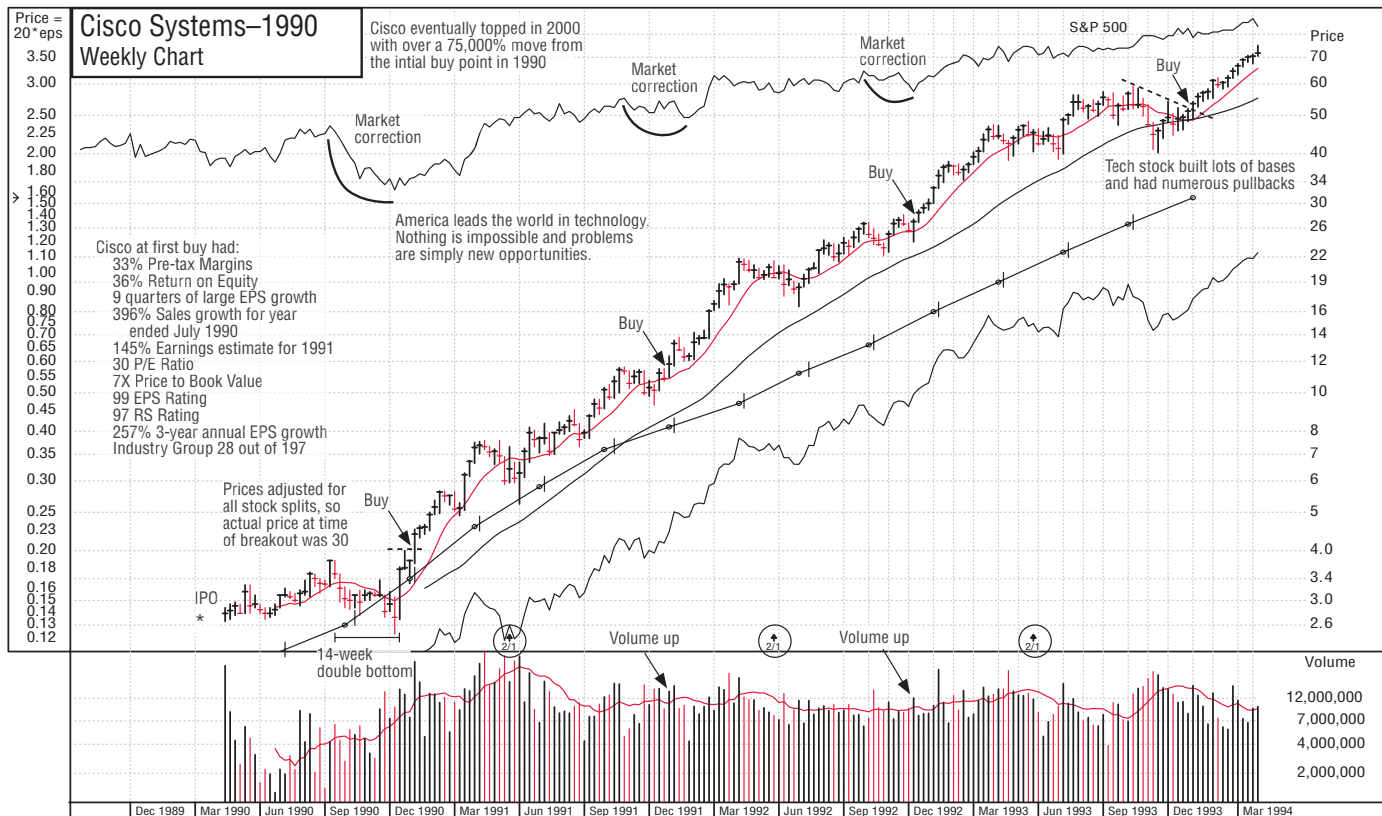
Amgen increased 681% in 96 weeks.



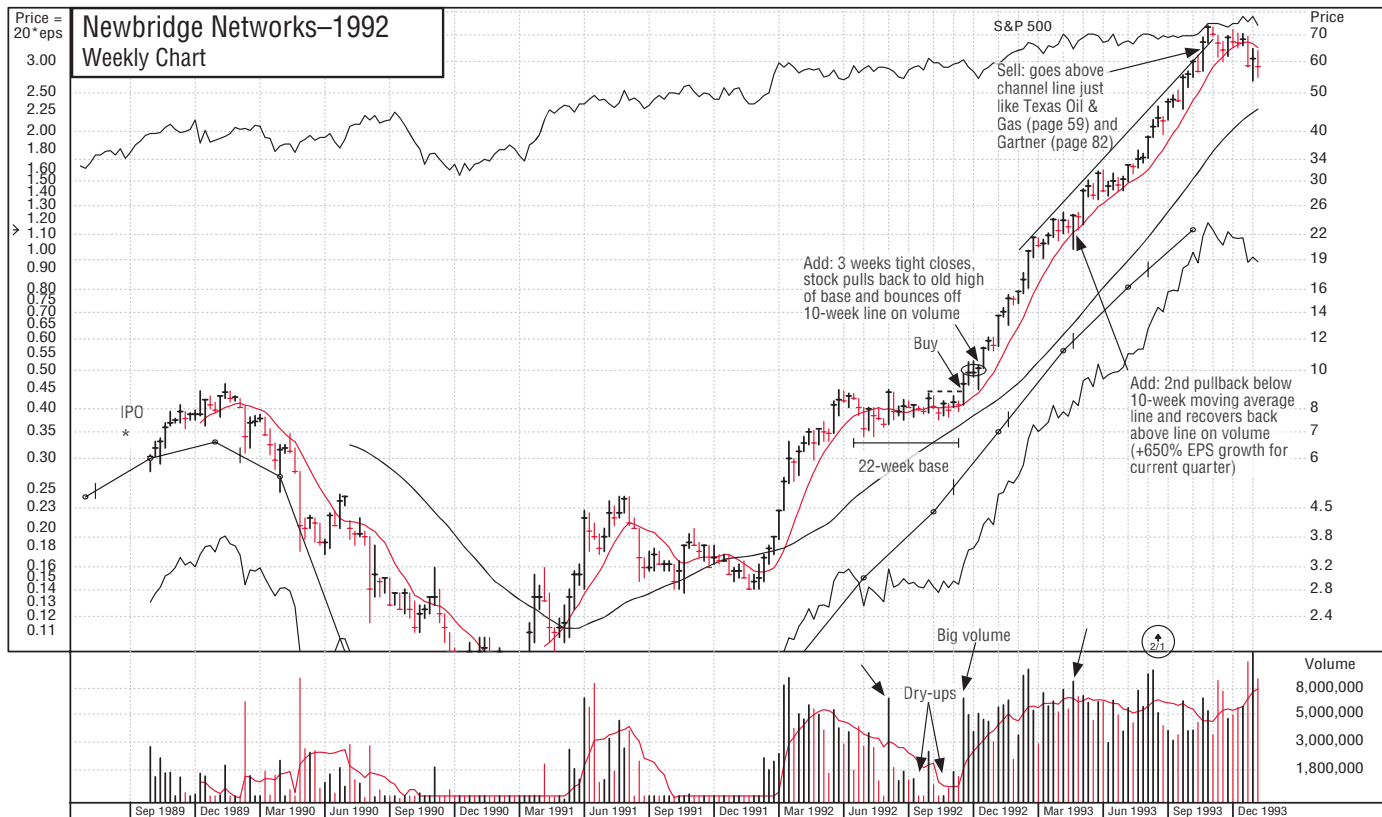
United States Surgical increased 786% in 93 weeks.



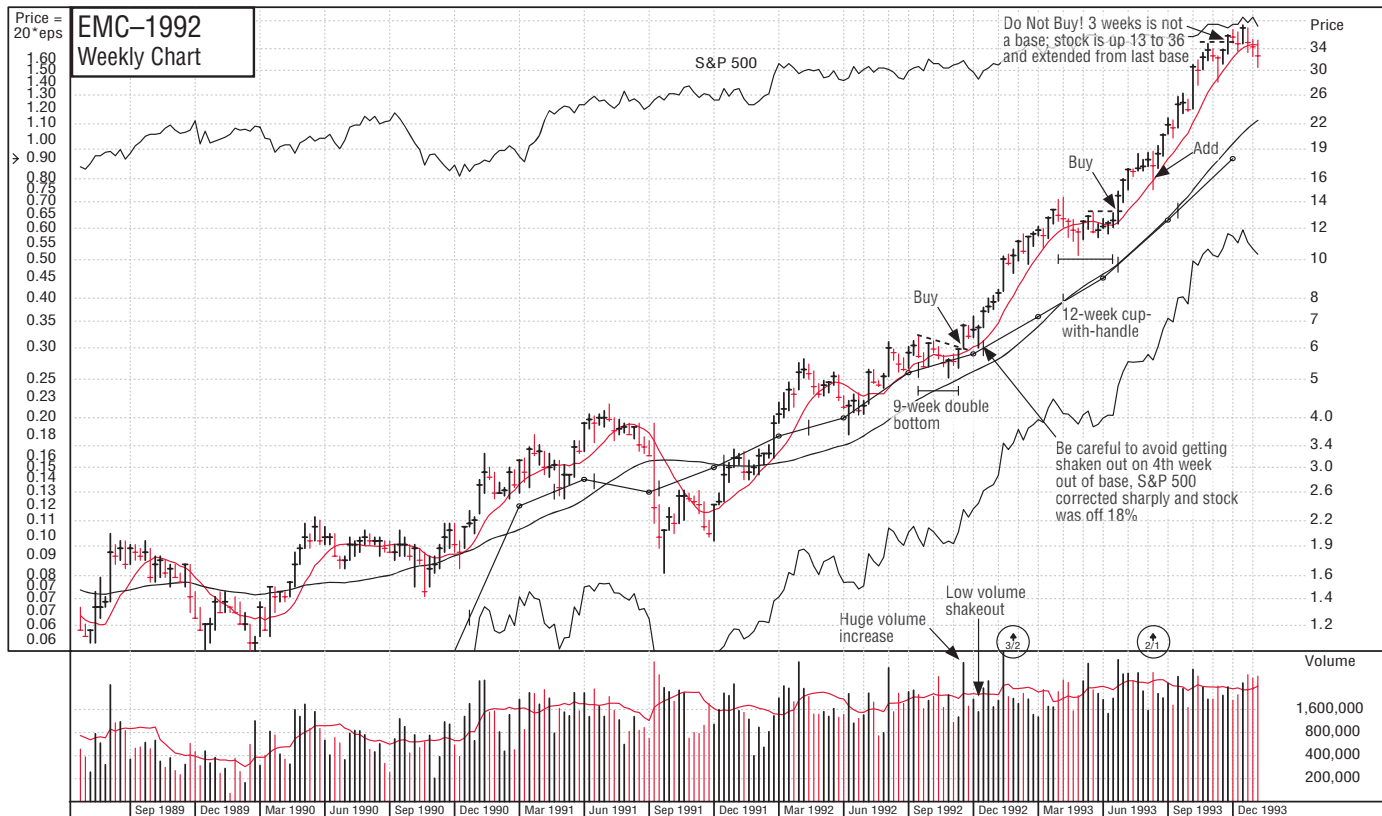
Healthcare Compare increased 540% in 61 weeks.



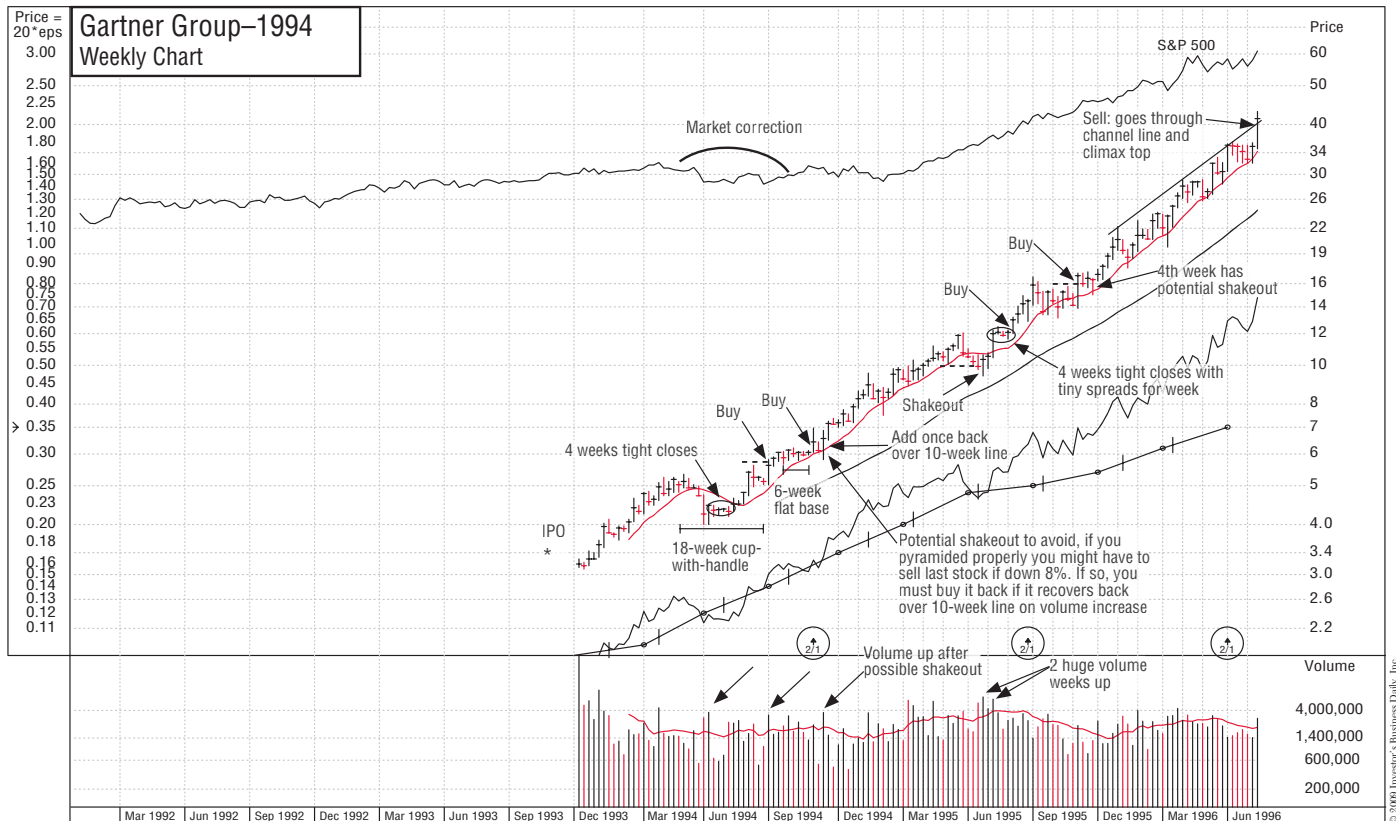
Cisco Systems increased 1602% in 169 weeks.



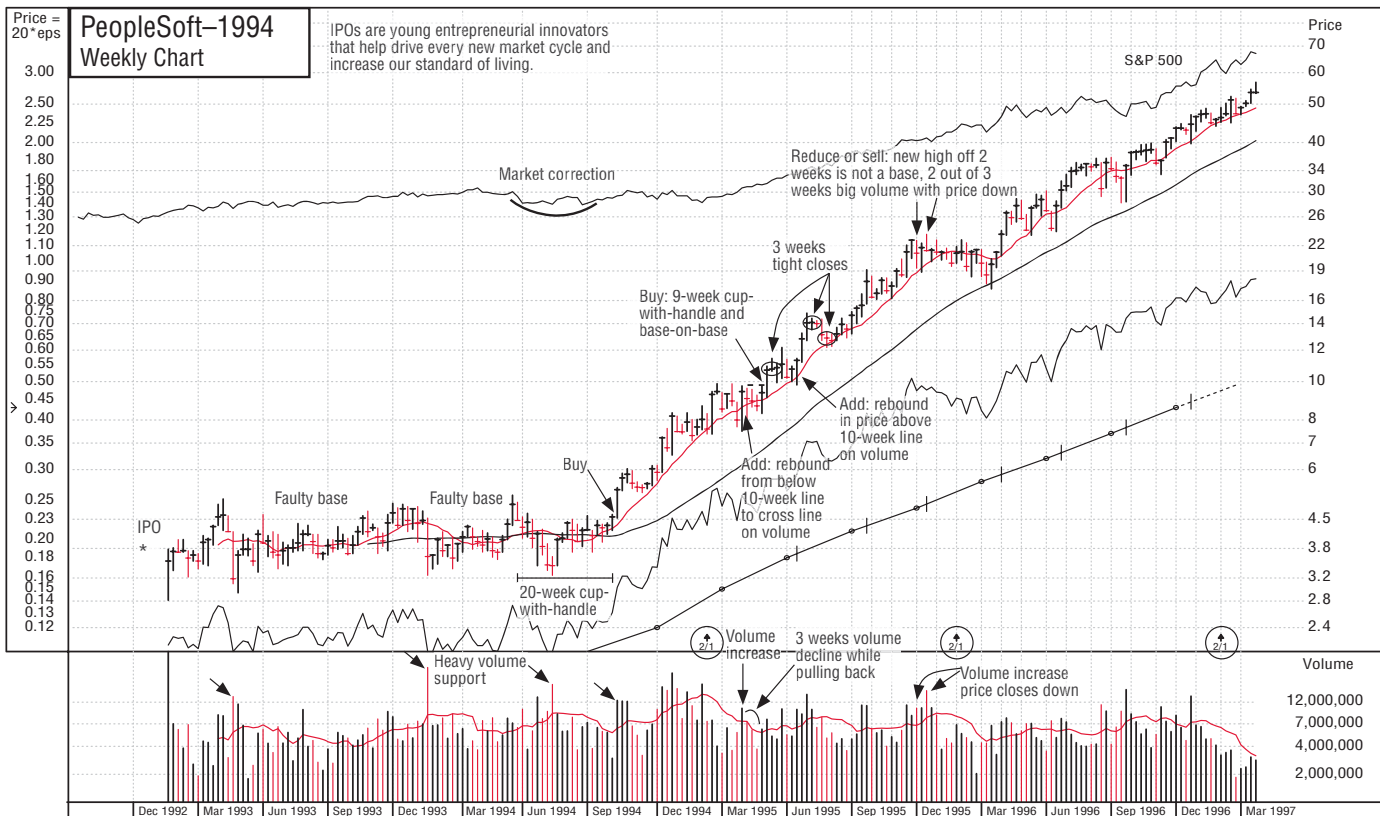
Newbridge Networks increased 699% in 49 weeks.



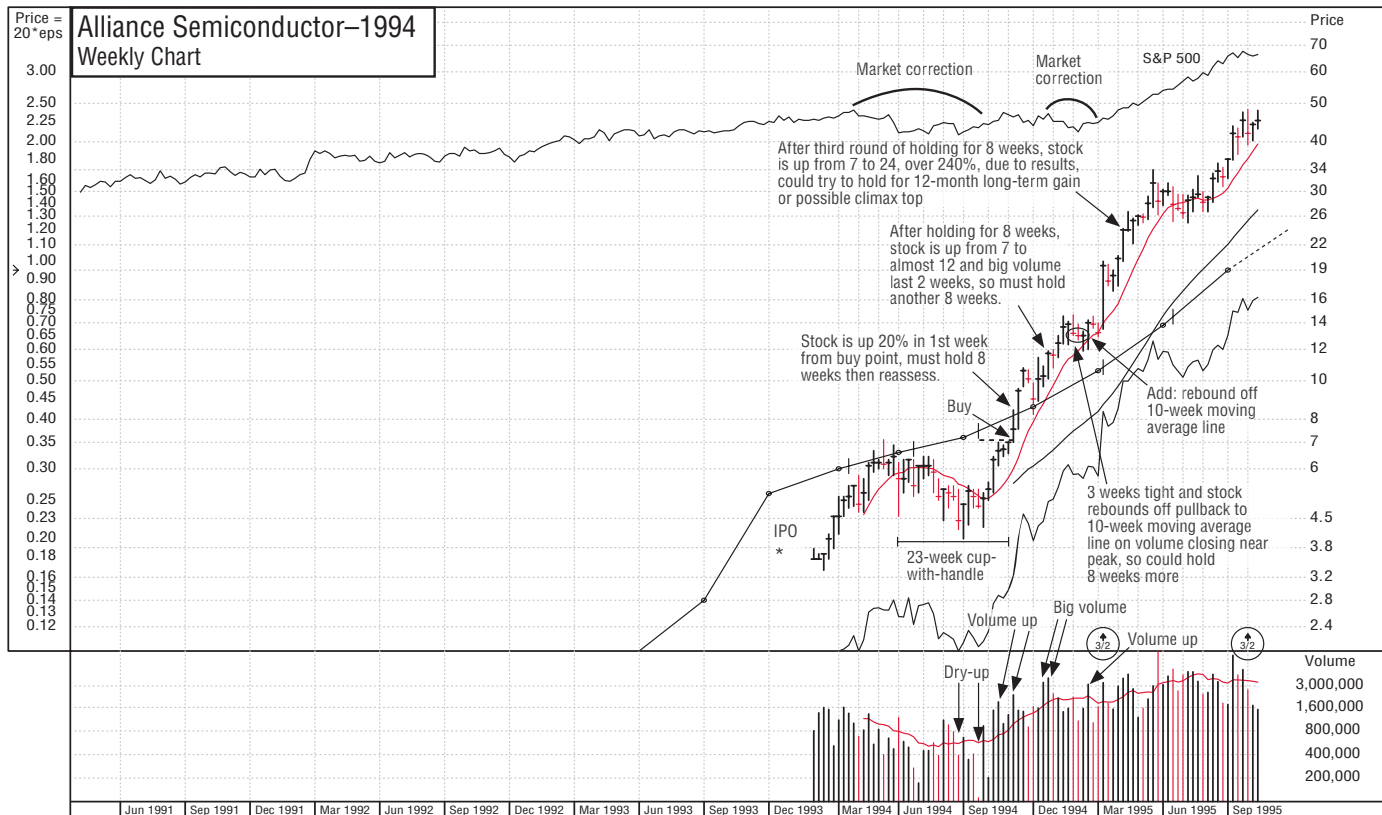
EMC increased 471% in 56 weeks.



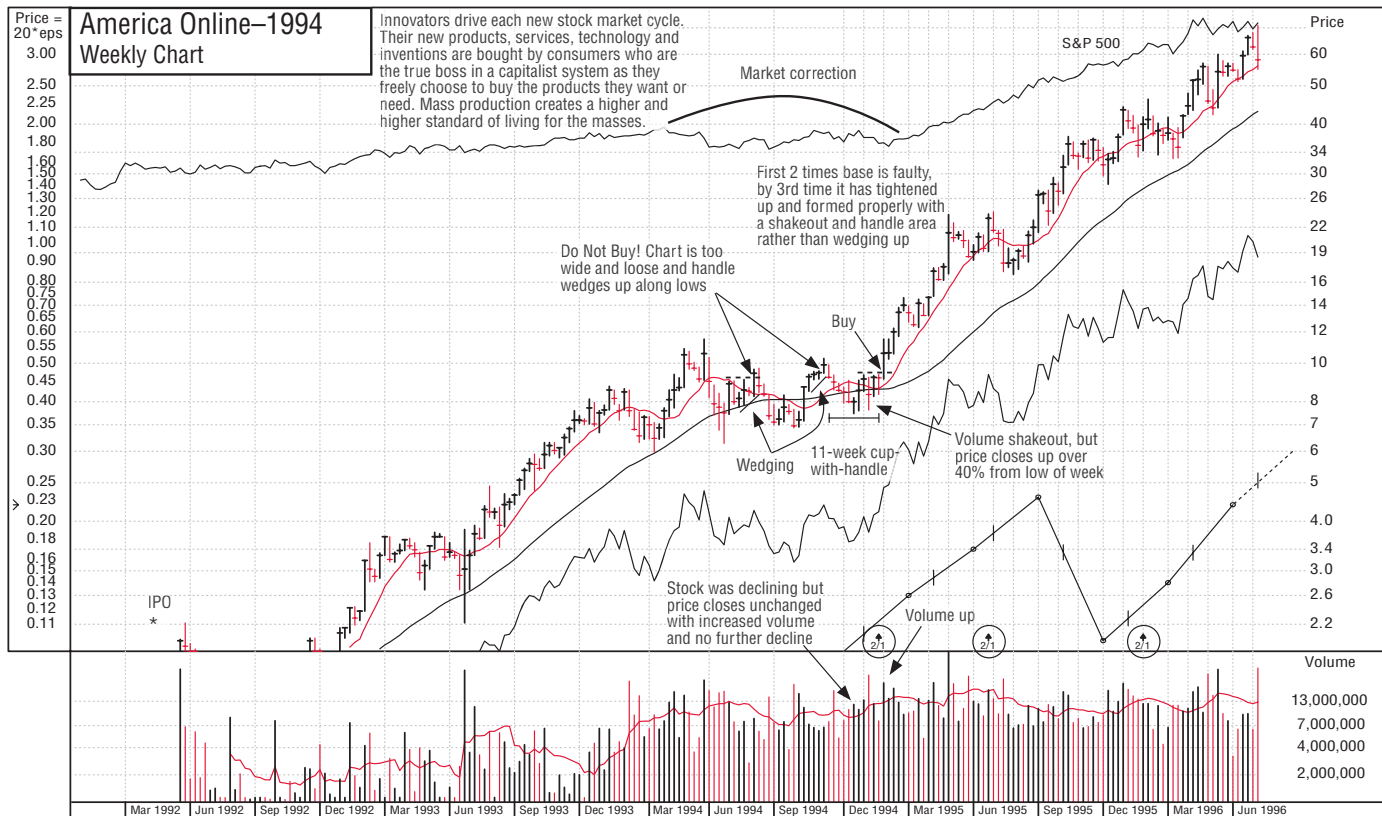
Gartner Group increased 667% in 98 weeks.



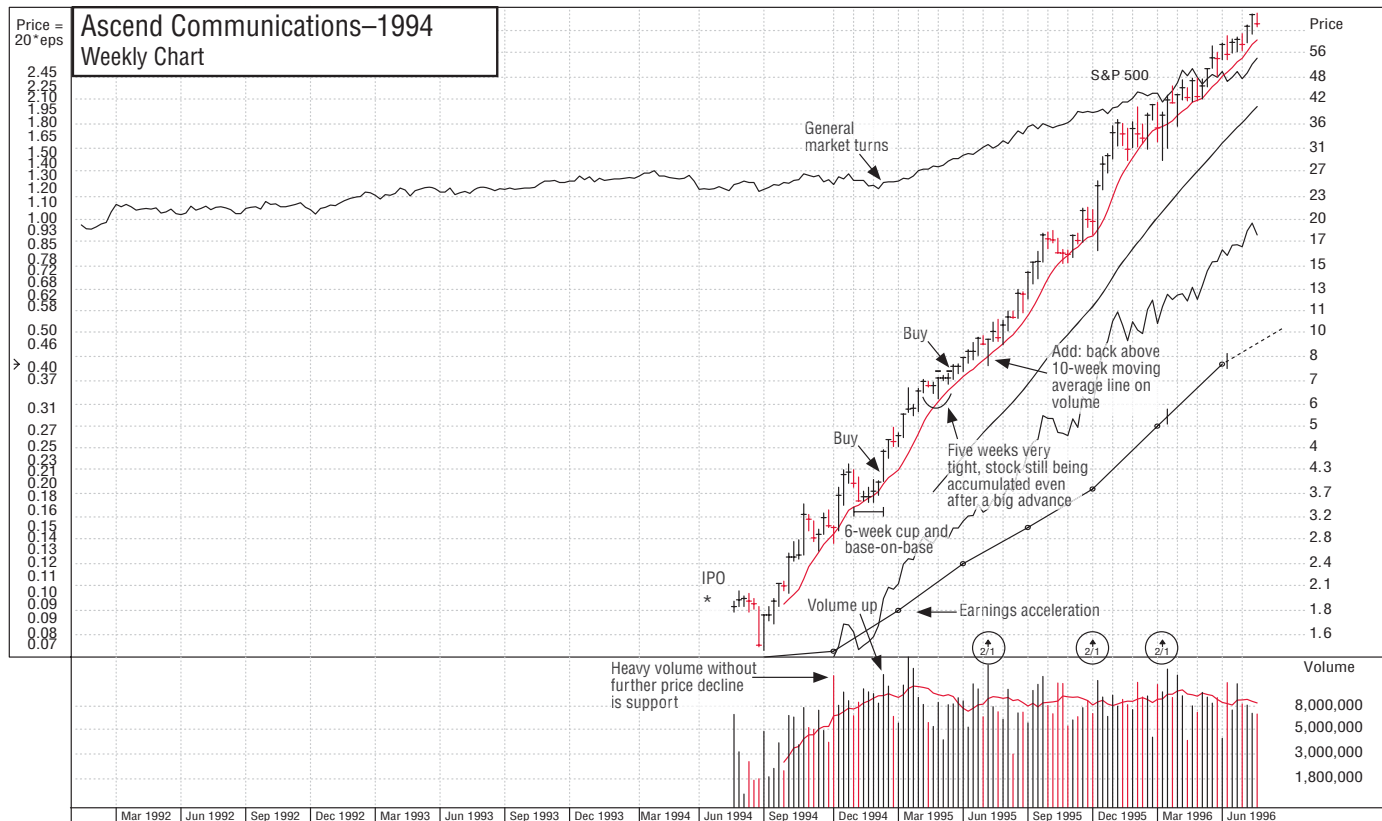
PeopleSoft increased 1145% in 129 weeks.



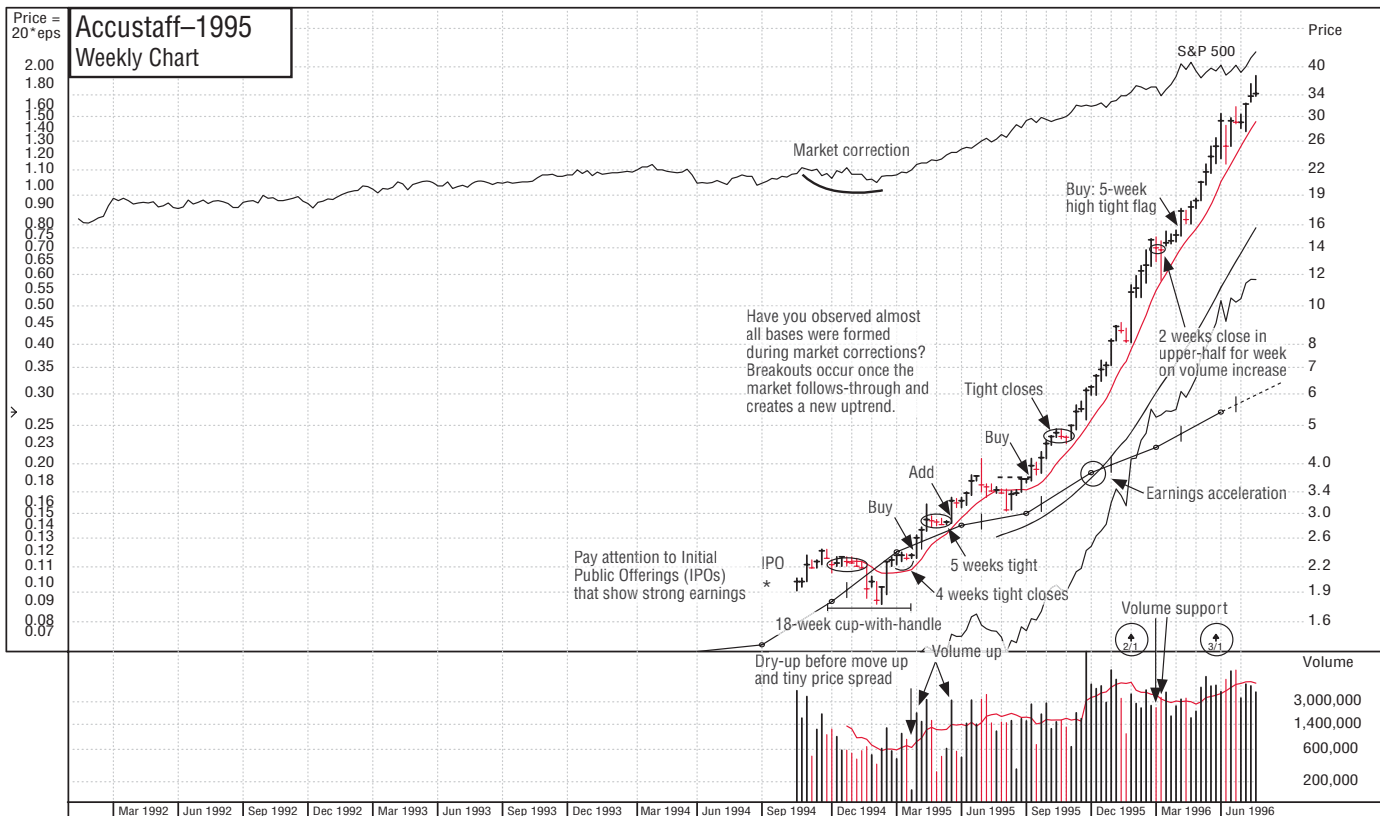
Alliance Semiconductor increased 539% in 47 weeks.



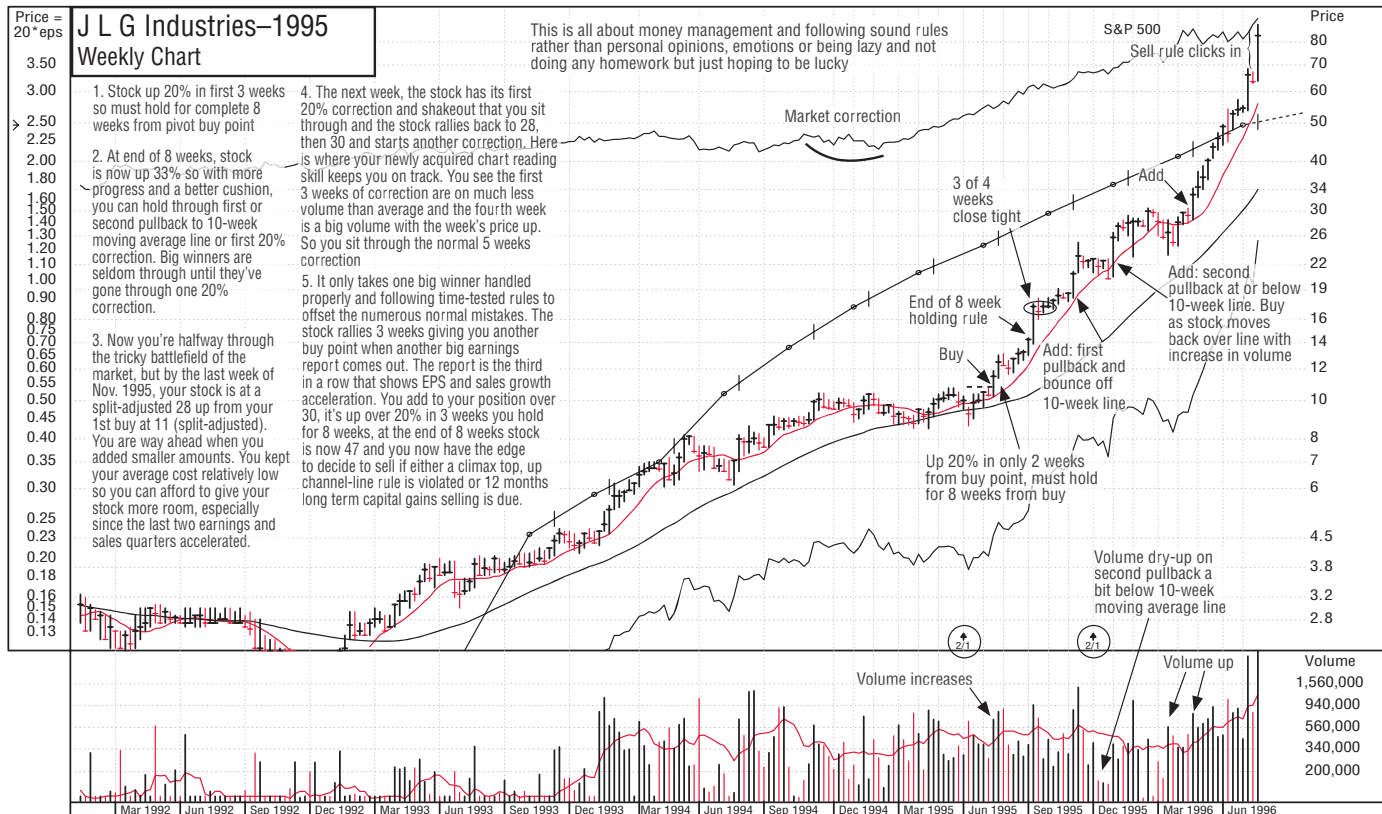
America Online increased 570% in 75 weeks.



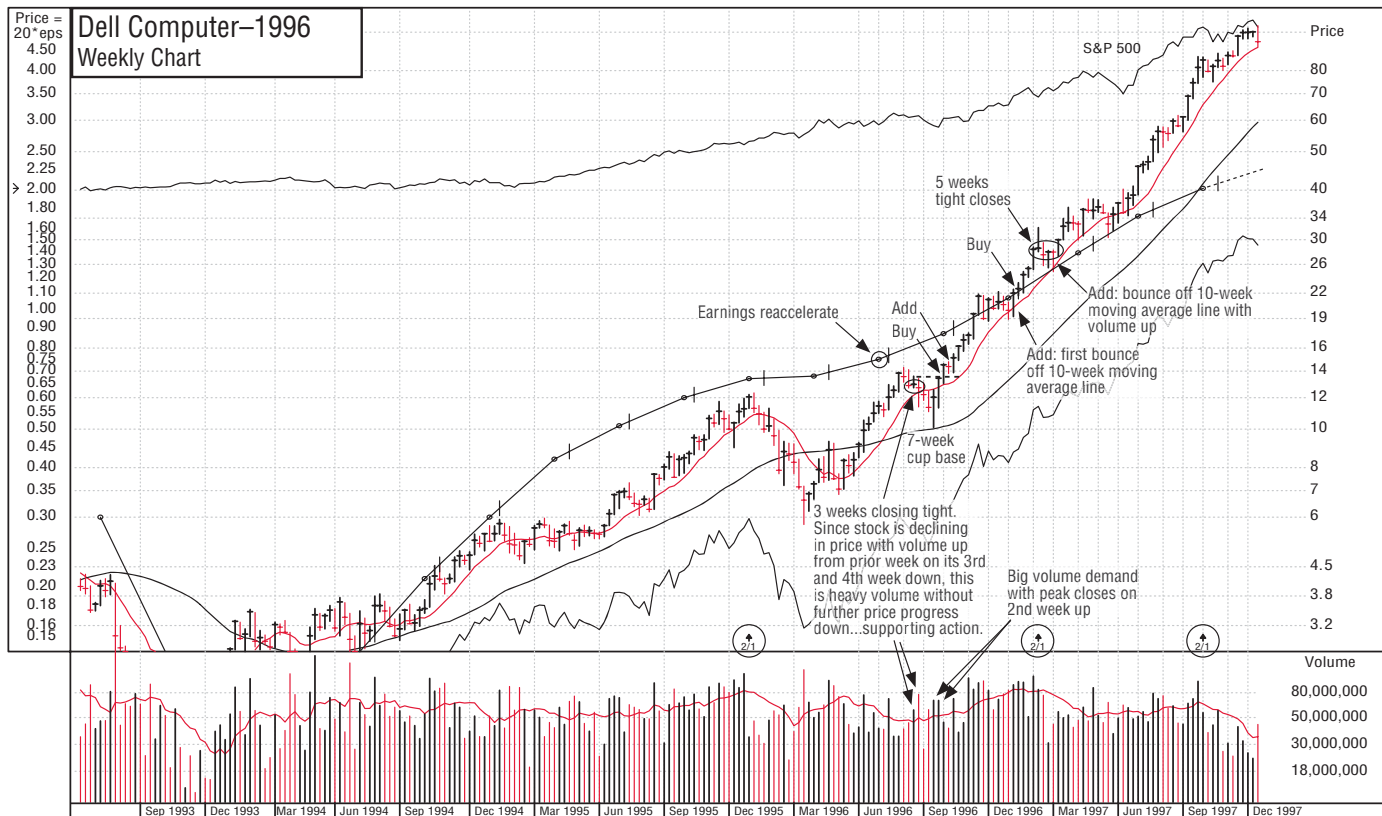
Ascend Communications increased 1384% in 75 weeks.



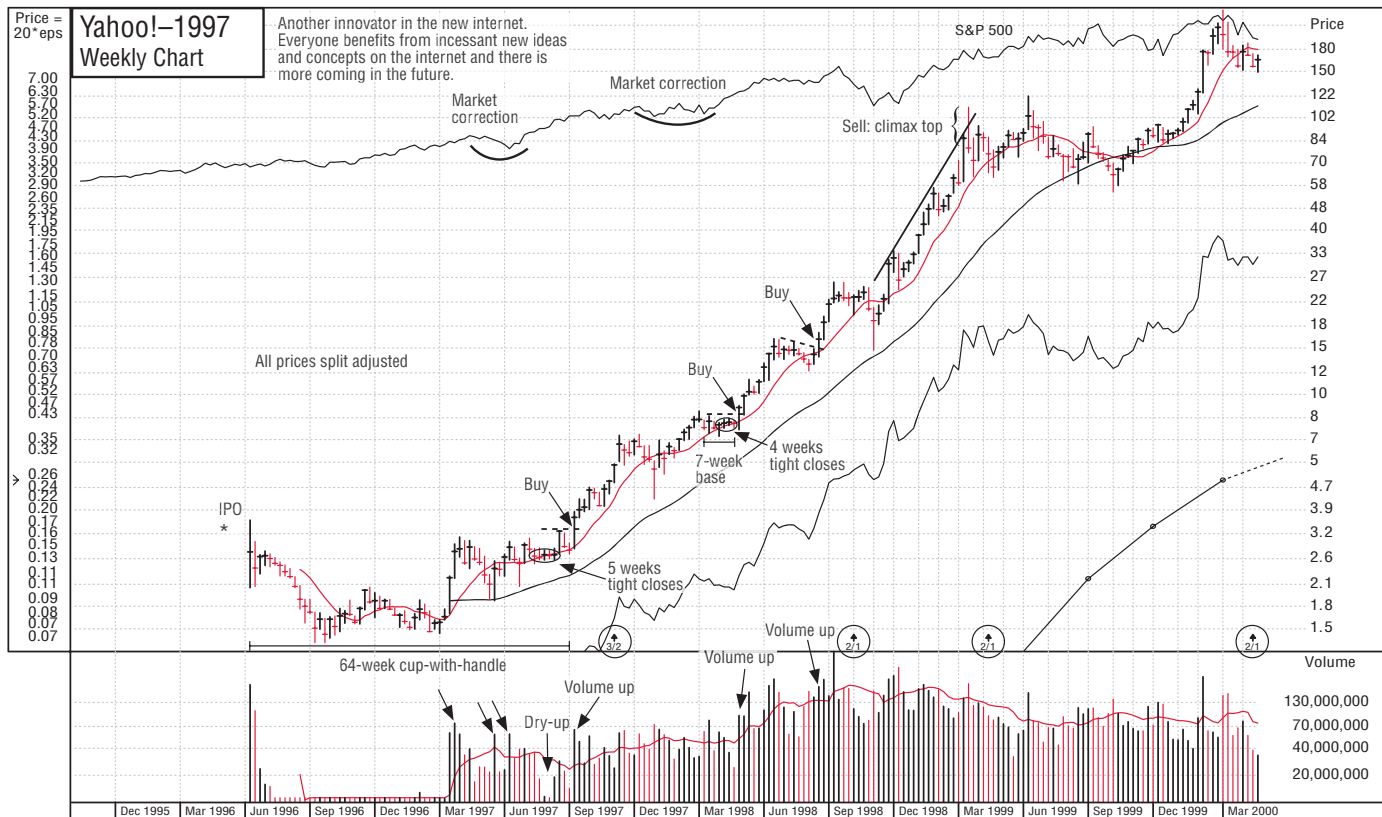
Accustaff increased 1359% in 68 weeks.



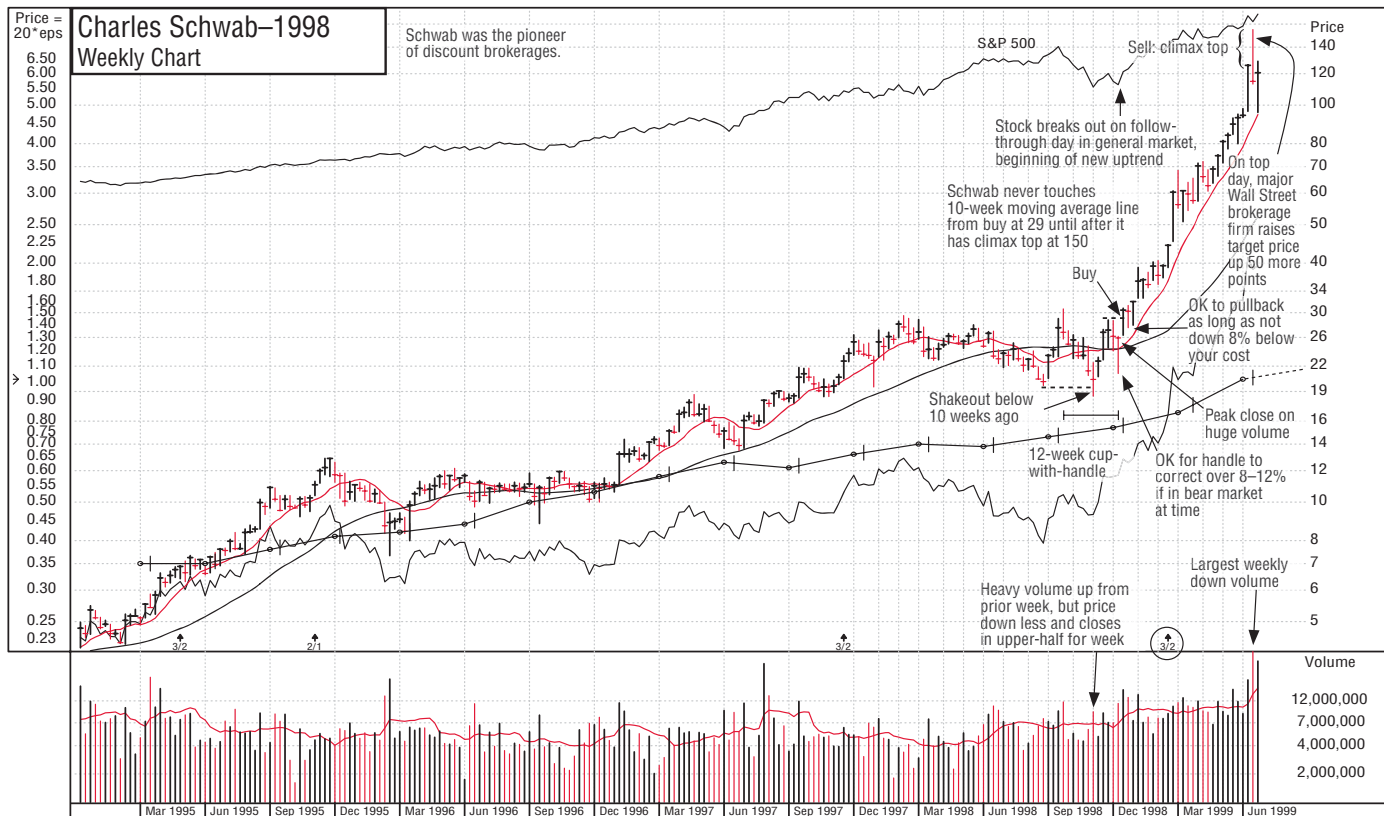
J L G Industries increased 670% in 53 weeks.



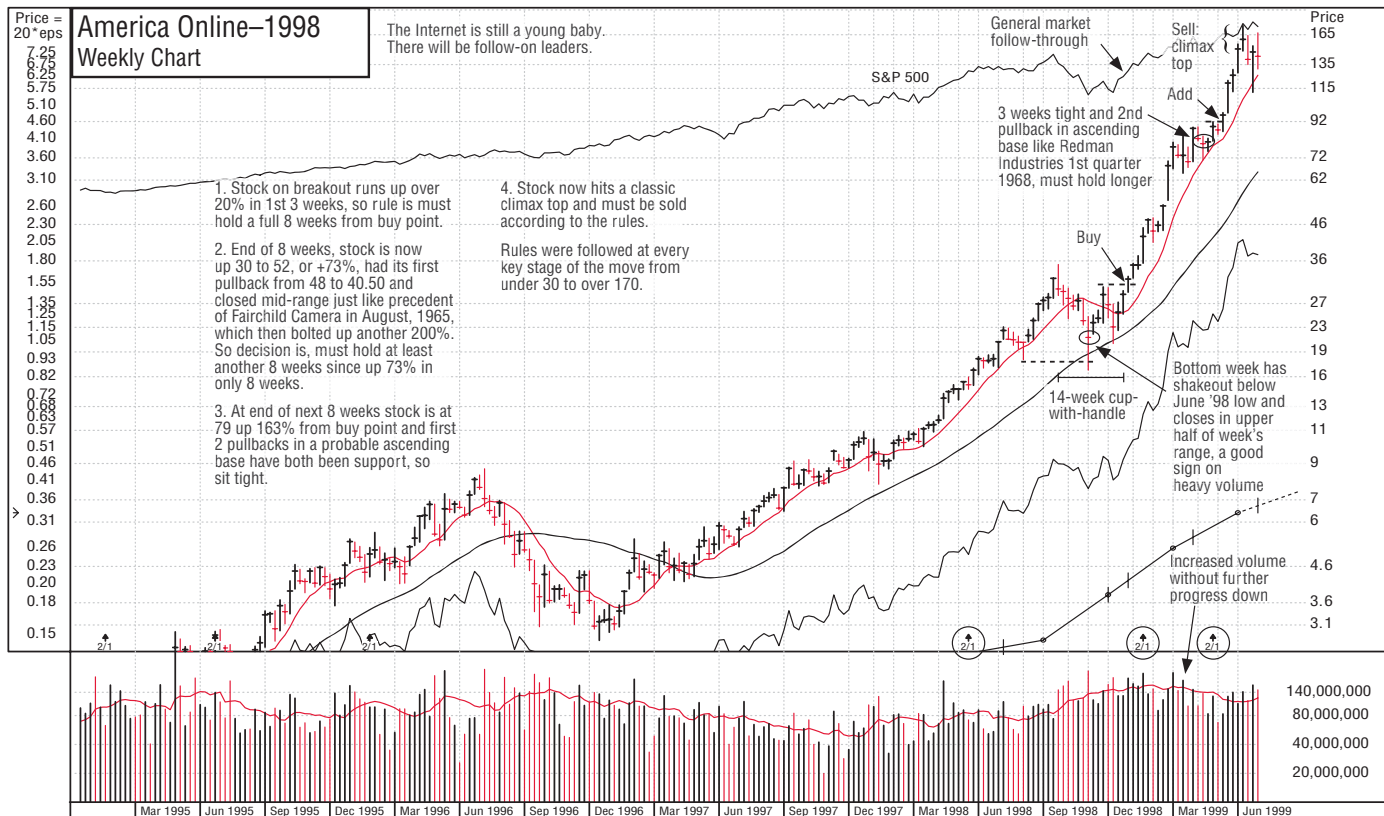
Dell Computer increased 587% in 61 weeks.



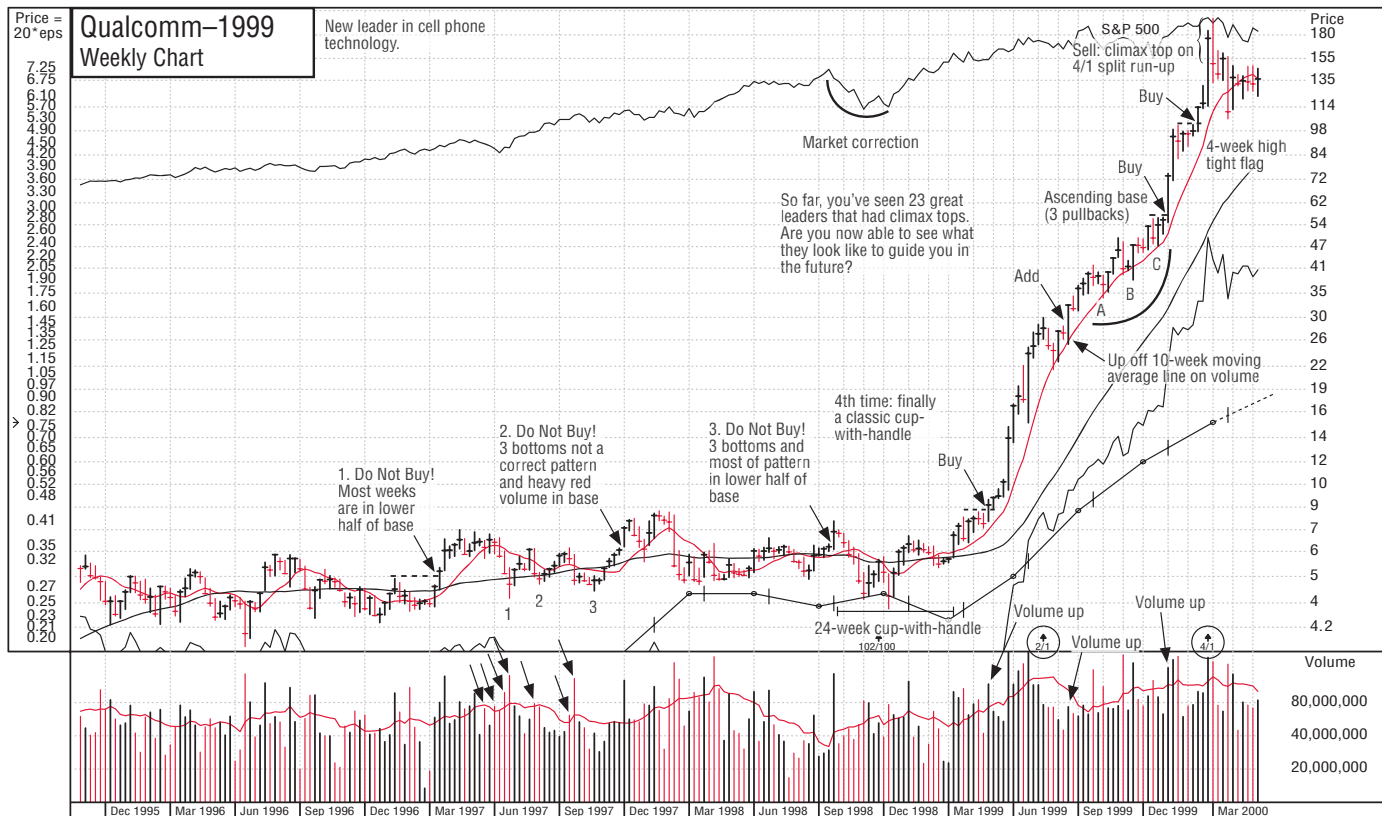
Yahoo! Increased 6723% in 130 weeks.



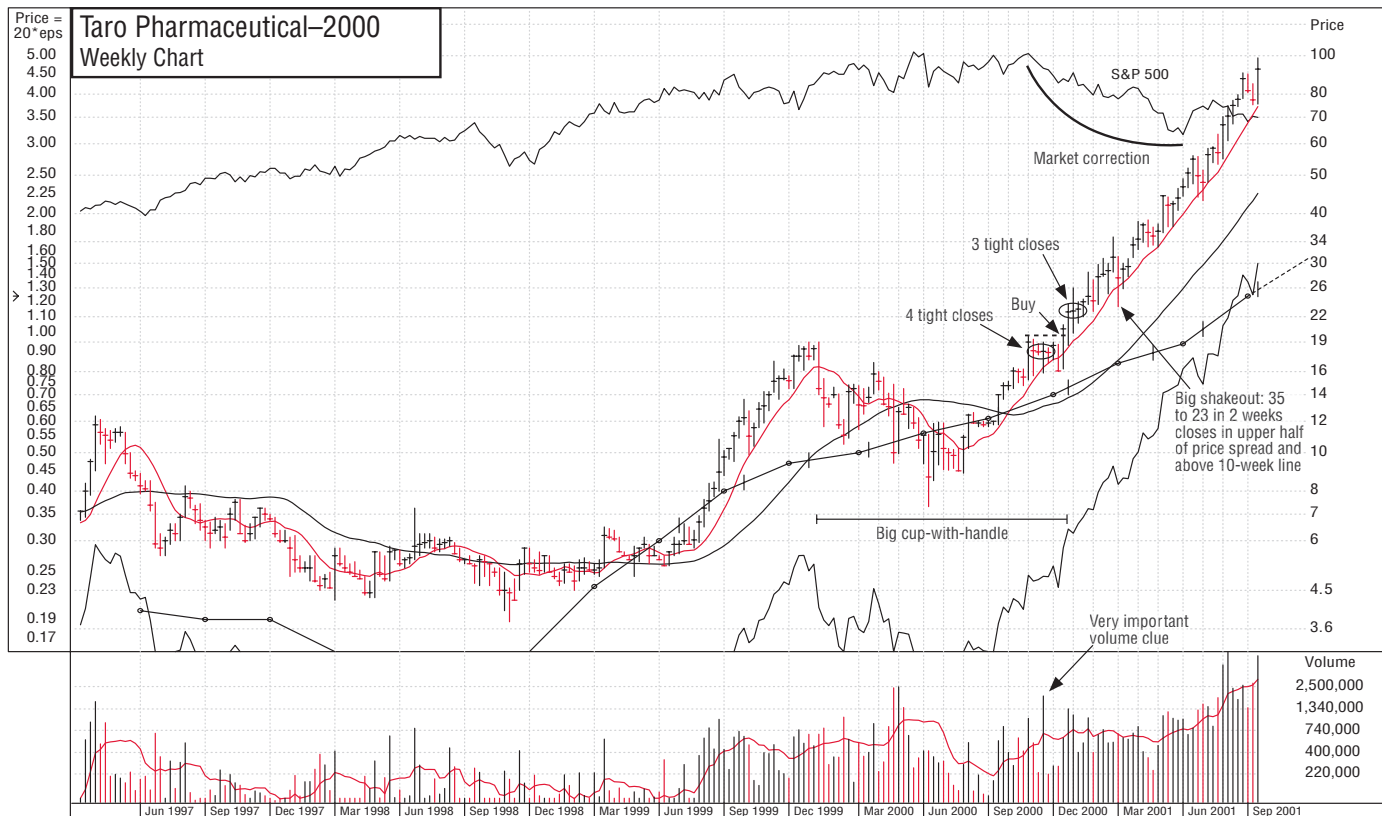
Charles Schwab increased 409% in 26 weeks.



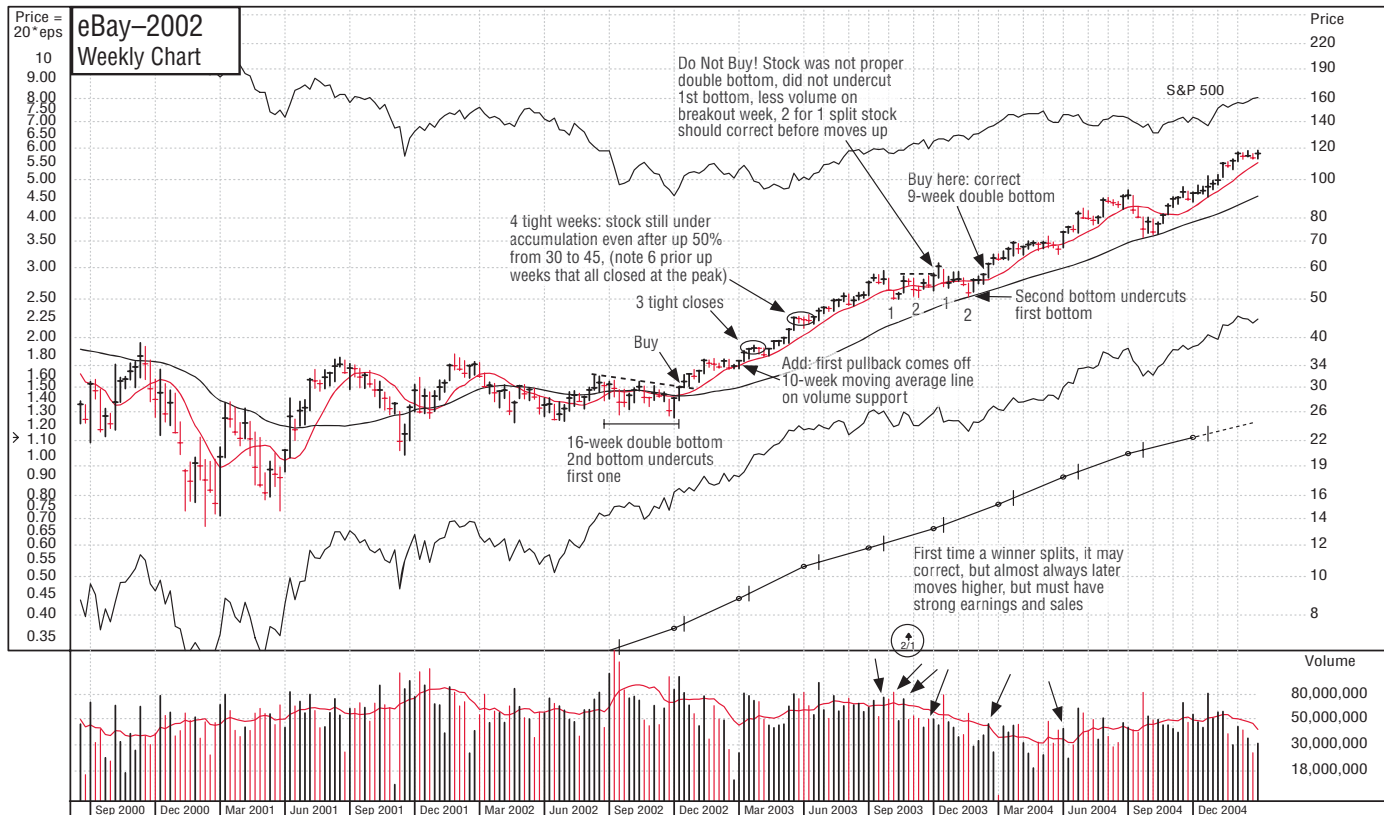
America Online increased 451% in 23 weeks.



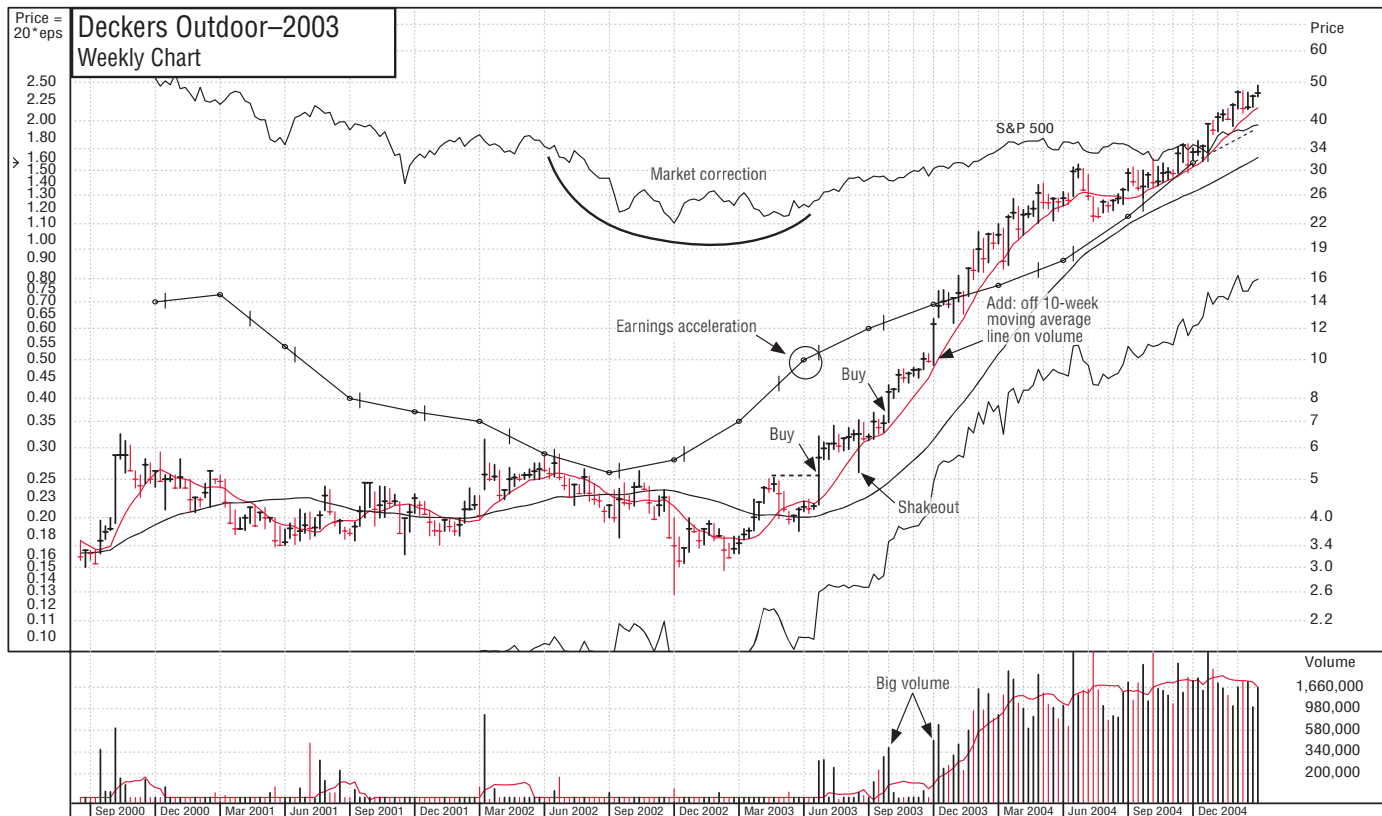
Qualcomm increased 2091% in 45 weeks.



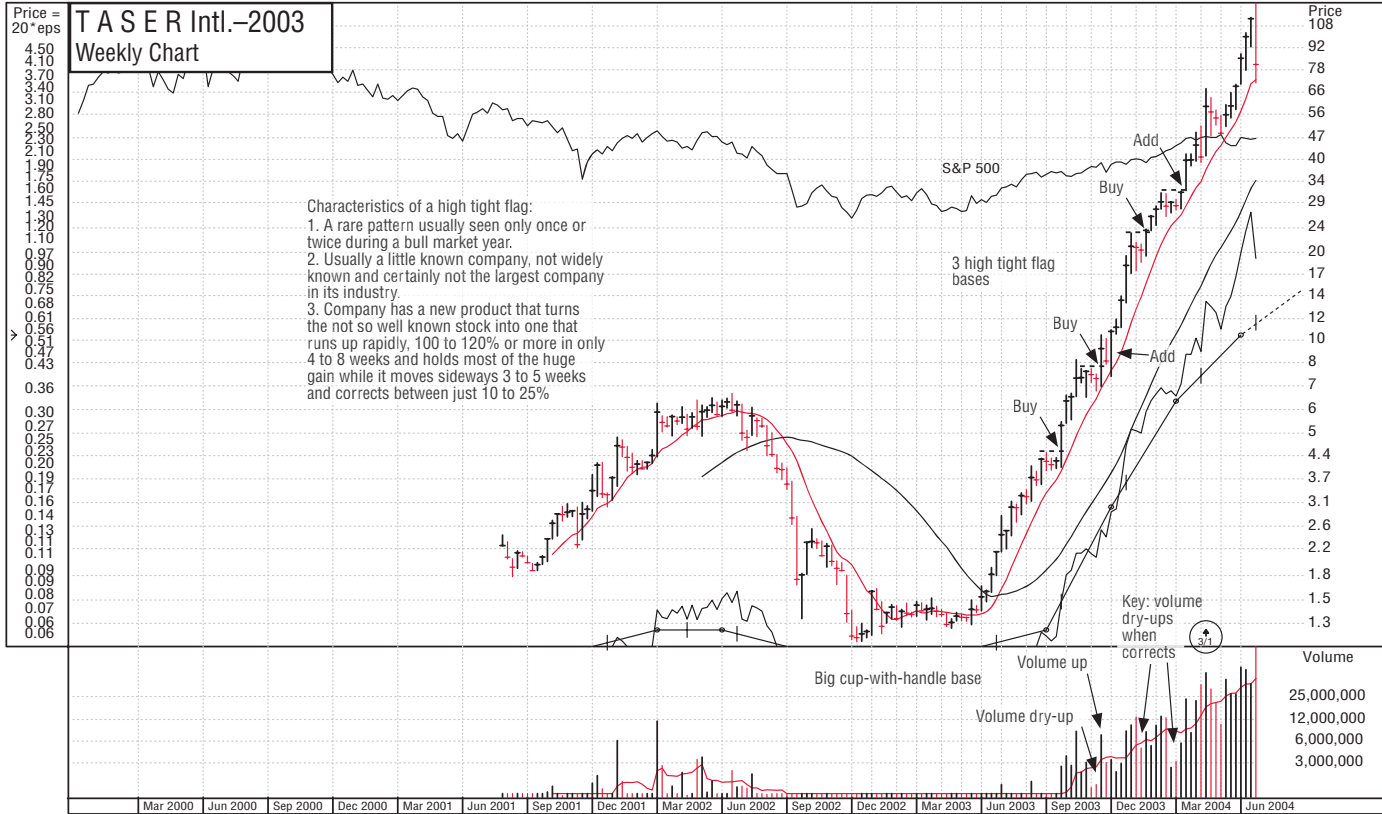
Taro Pharmaceuticals increased 382% in 39 weeks.



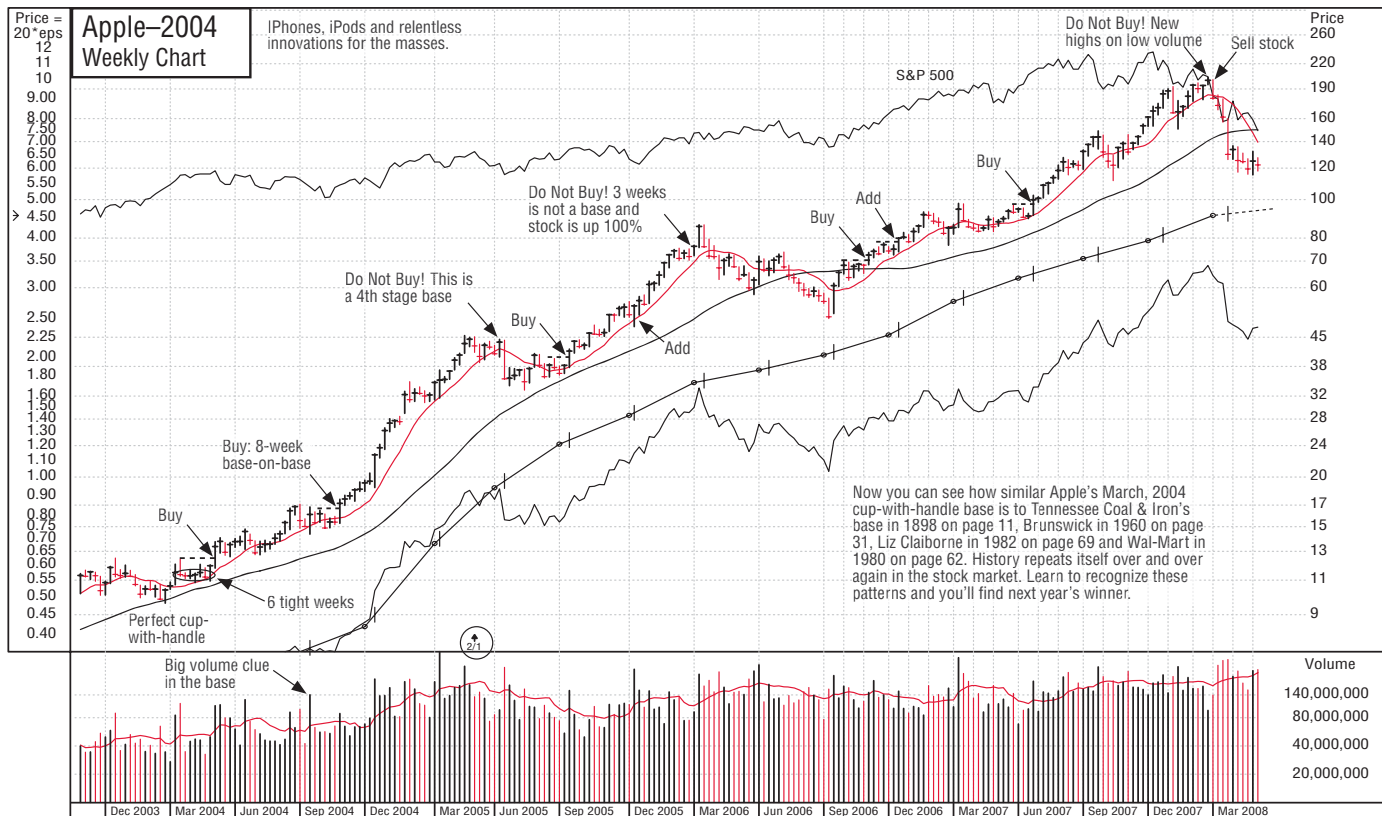
eBay increased 282% in 115 weeks.



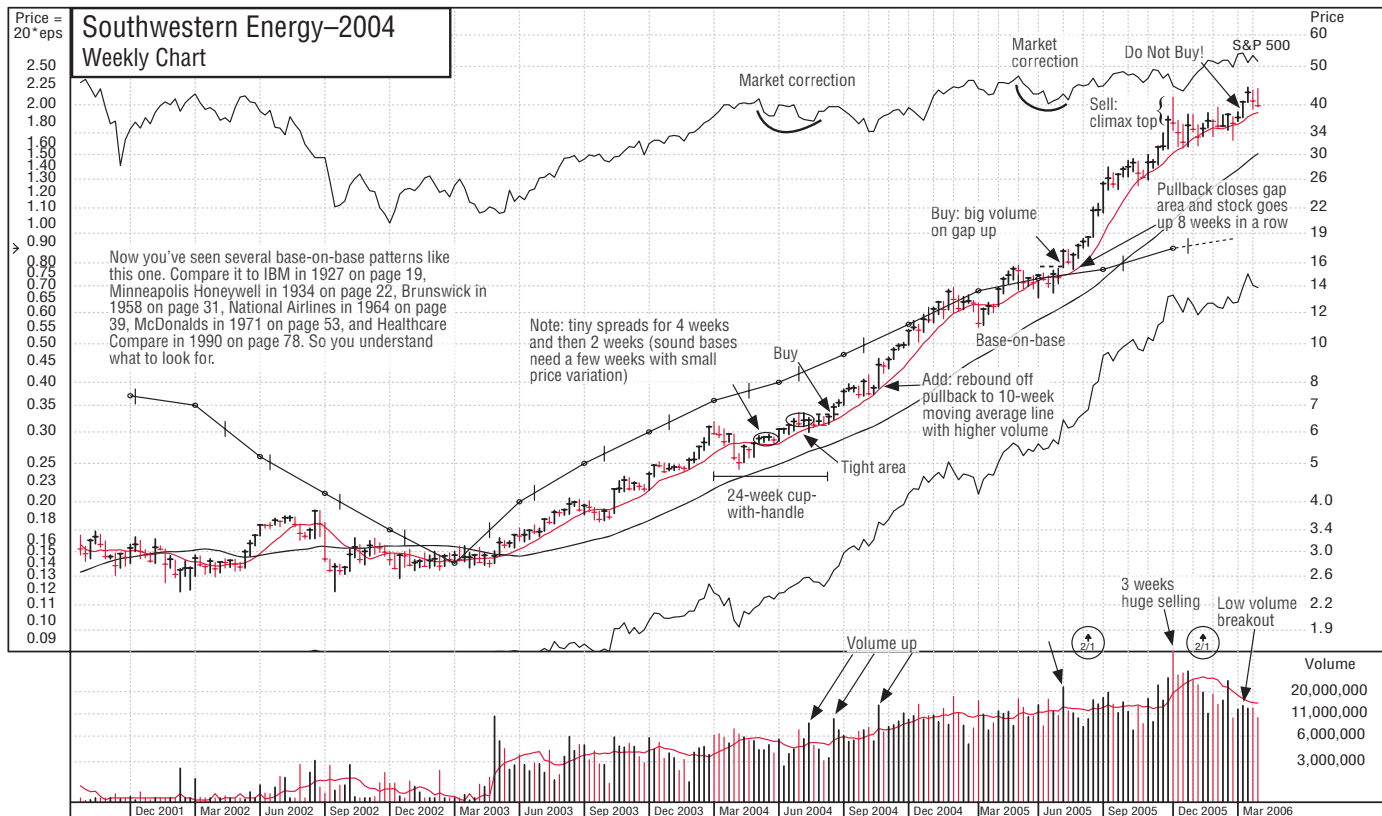
Deckers Outdoor increased 766% in 88 weeks.



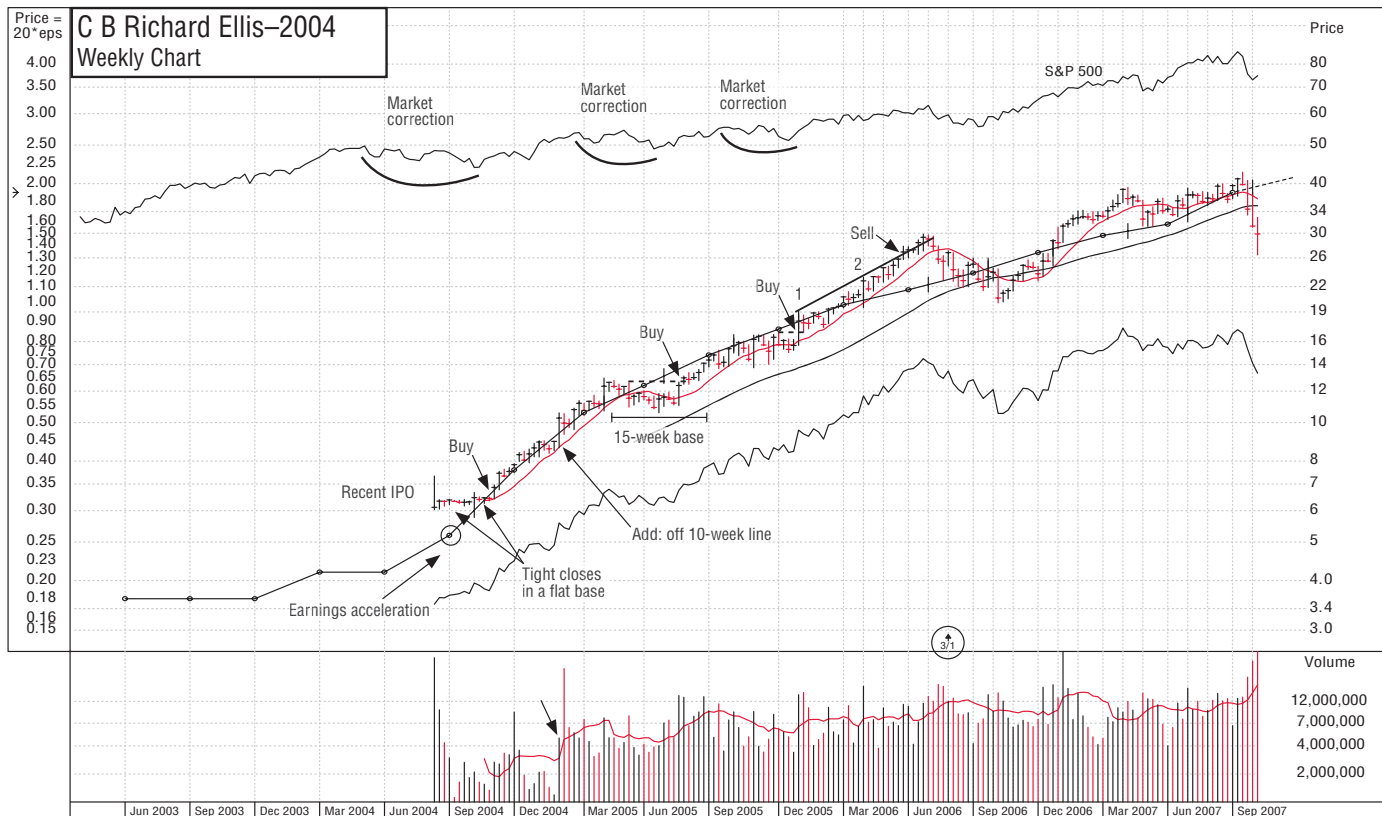
T A S E R International increased 2228% in 39 weeks.



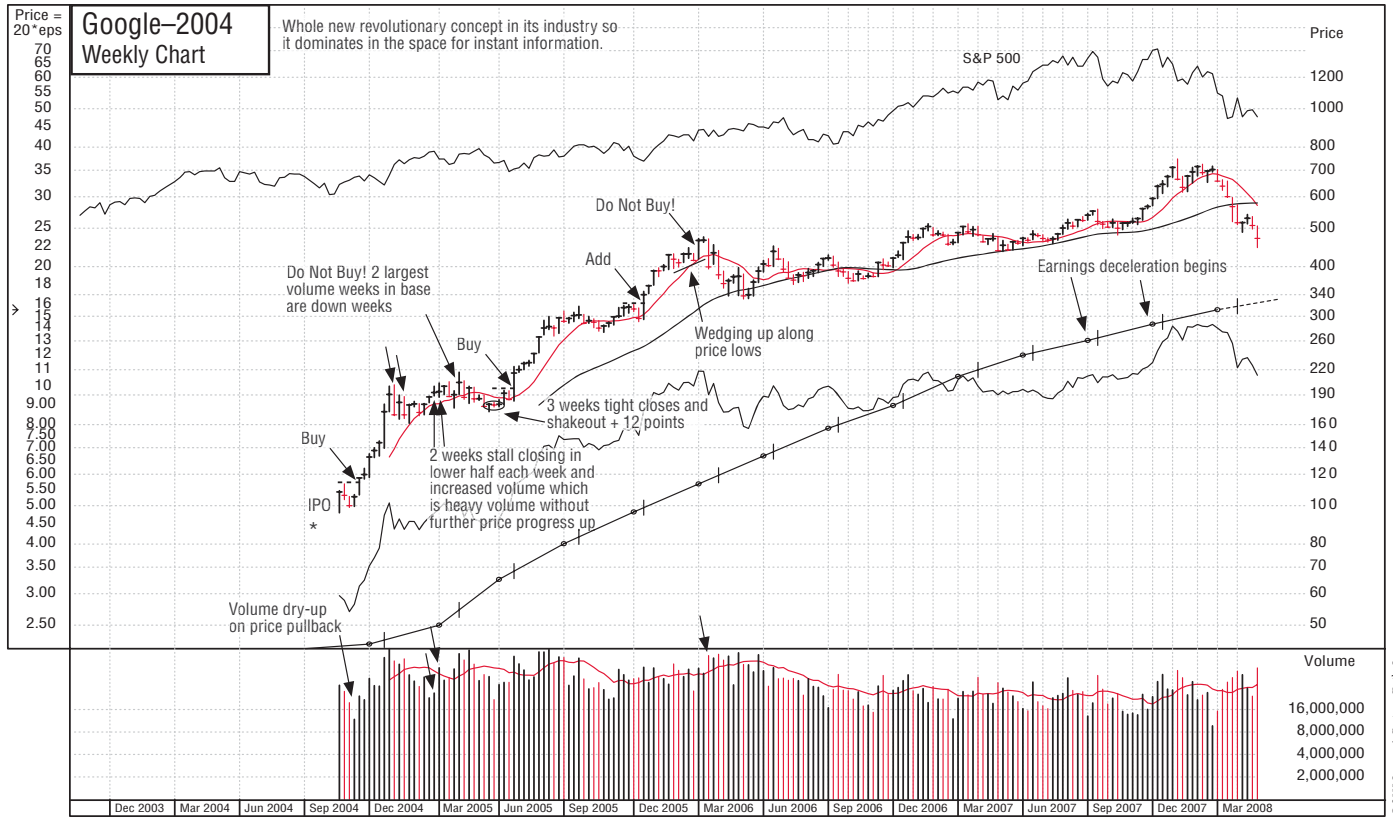
Apple increased 1418% in 199 weeks.



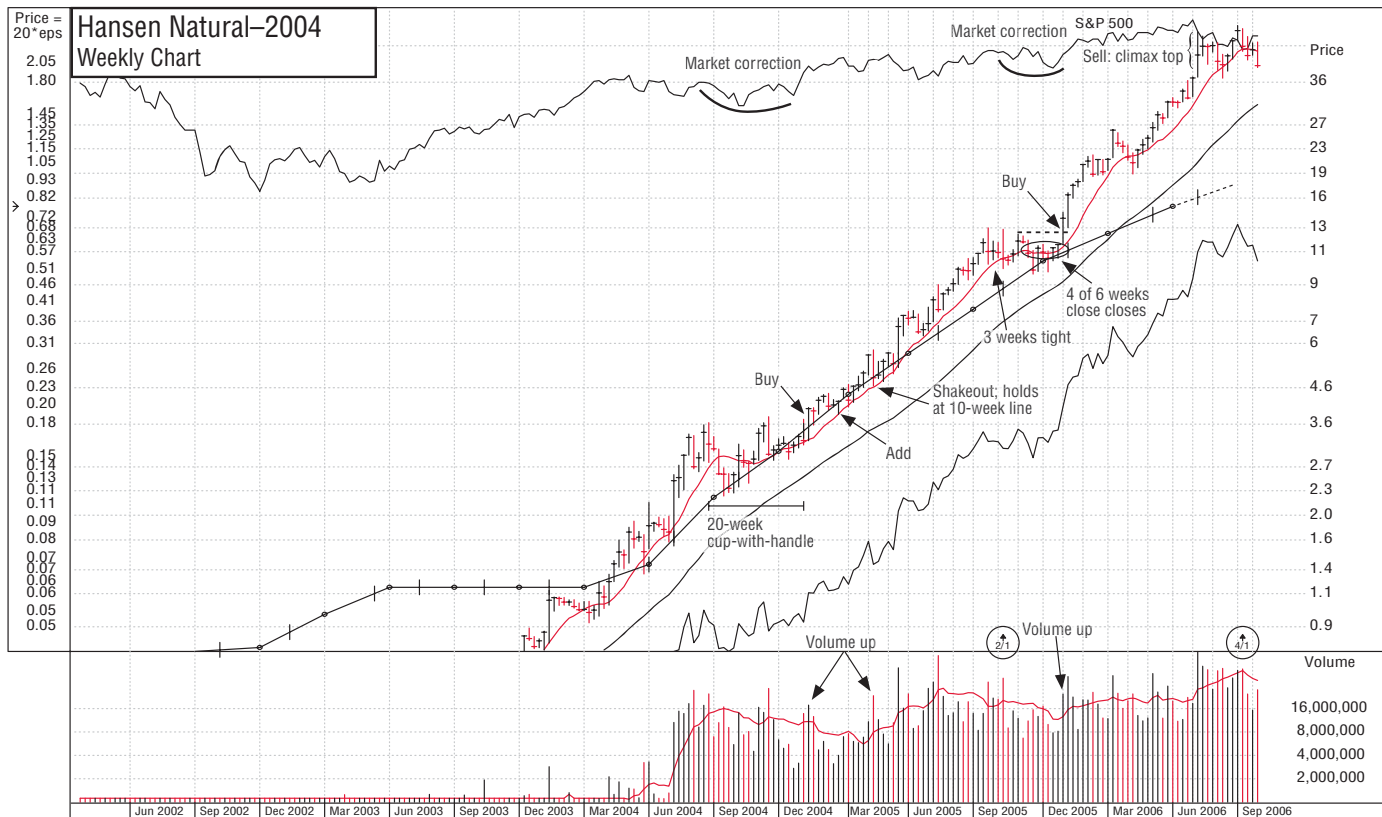
Southwestern Energy increased 556% in 83 weeks.



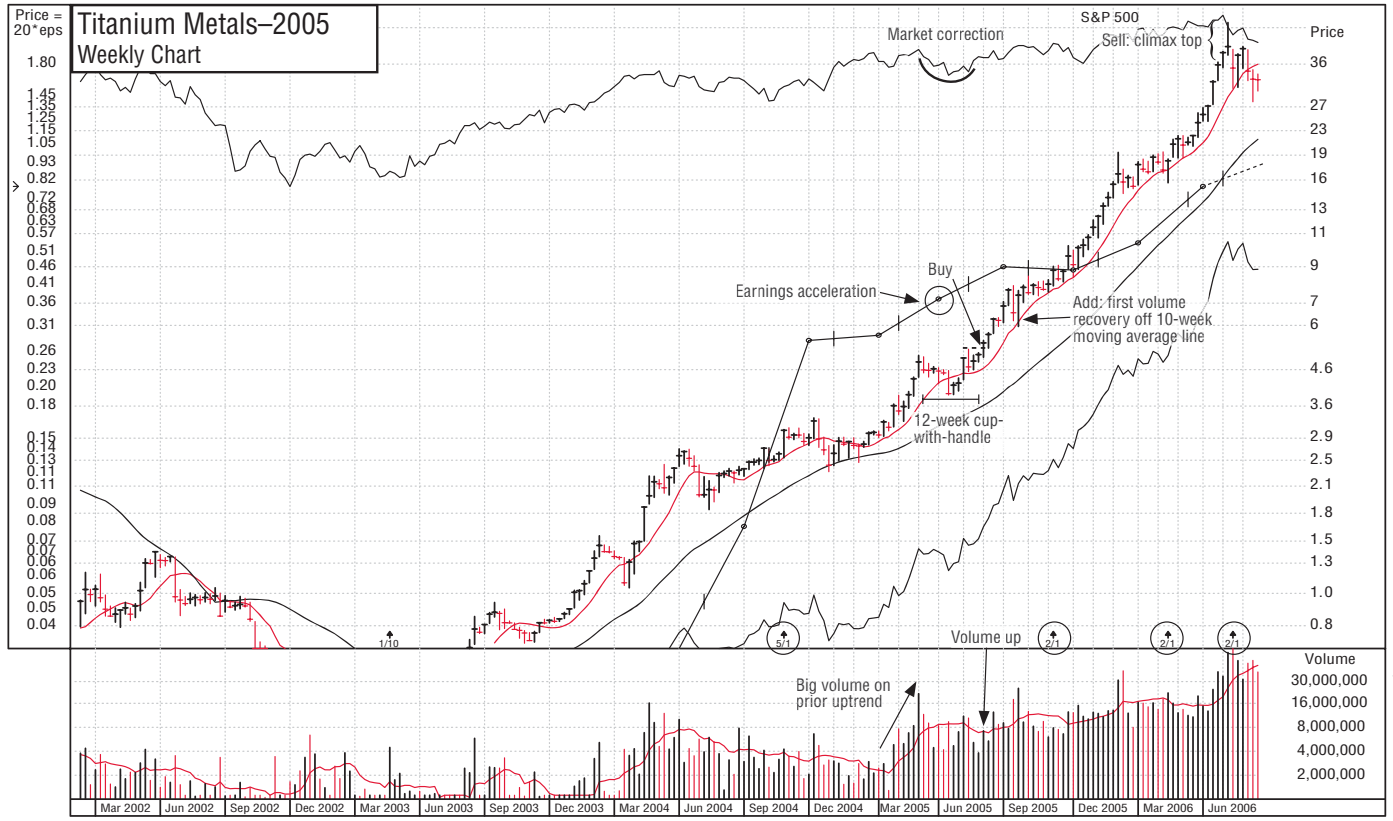
C B Richard Ellis Group increased 538% in 149 weeks.



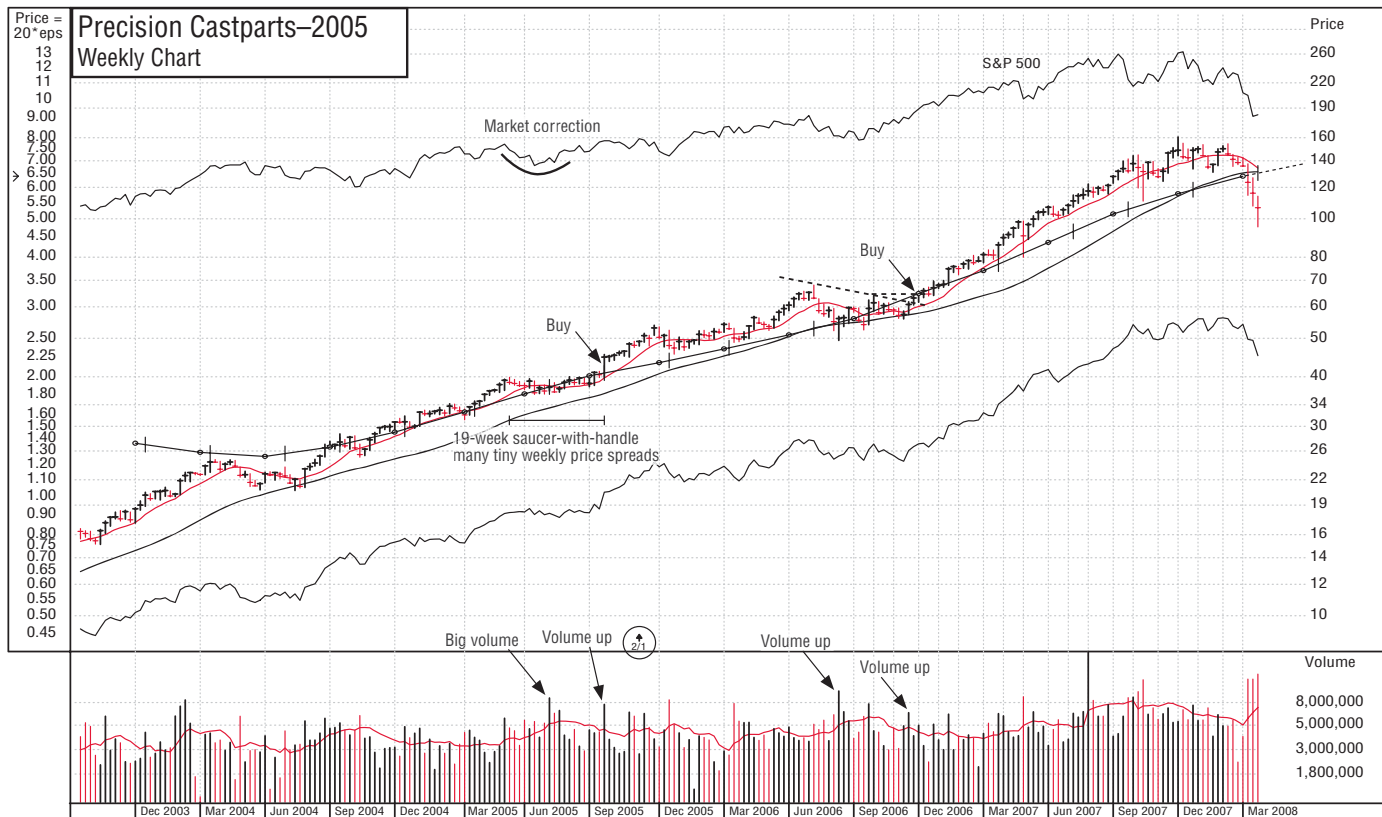
Google increased 536% in 164 weeks.



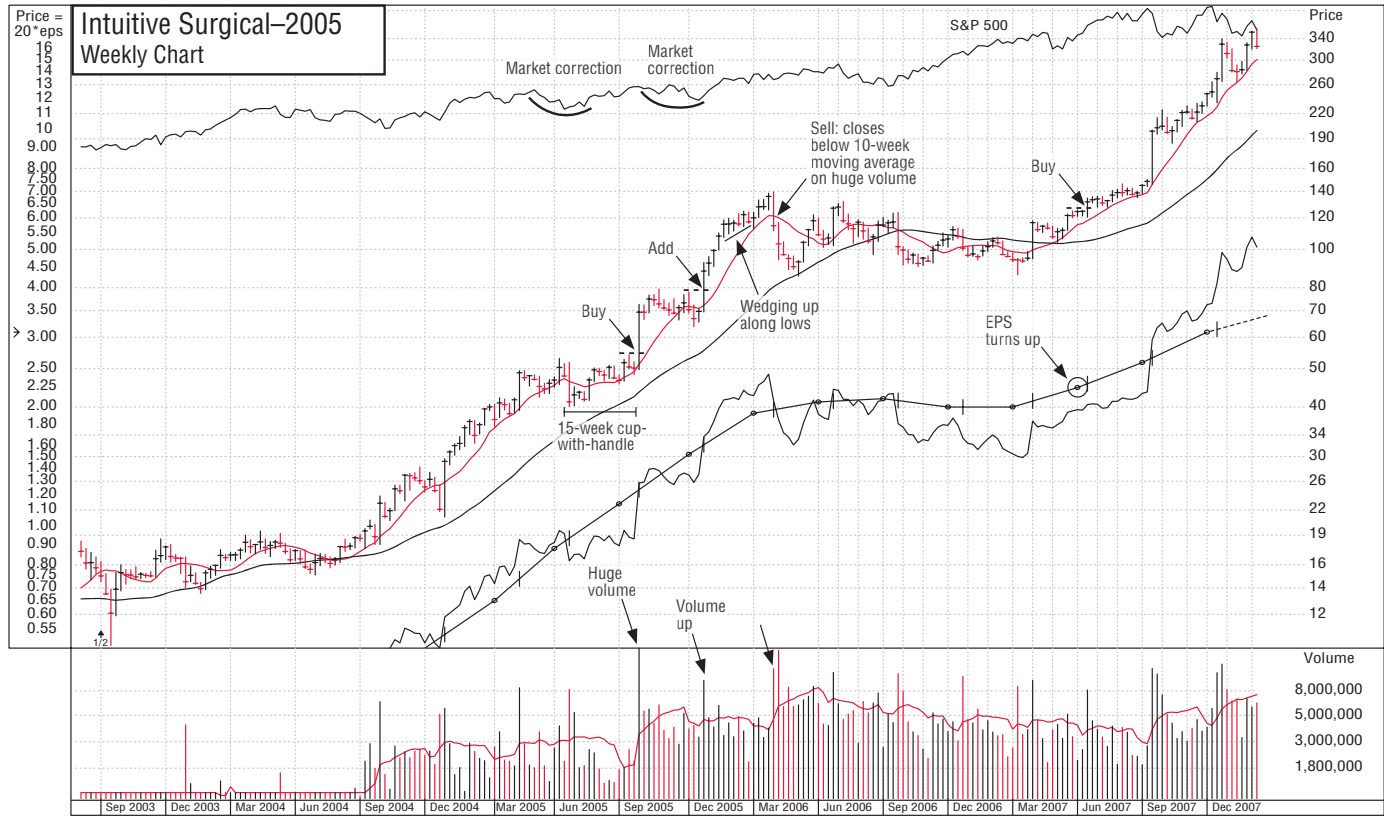
Hansen Natural increased 1219% in 86 weeks.



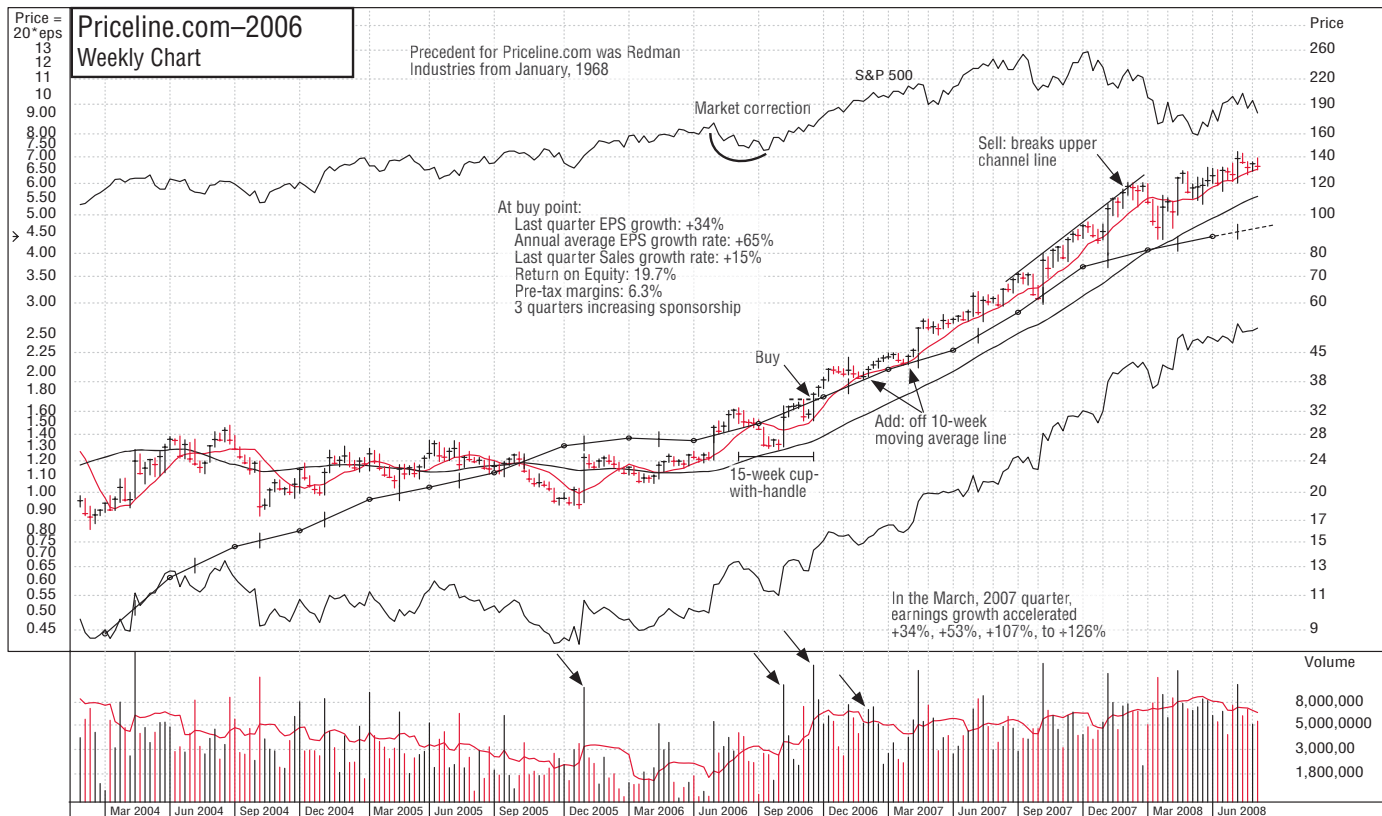
Titanium Metals increased 764% in 49 weeks.



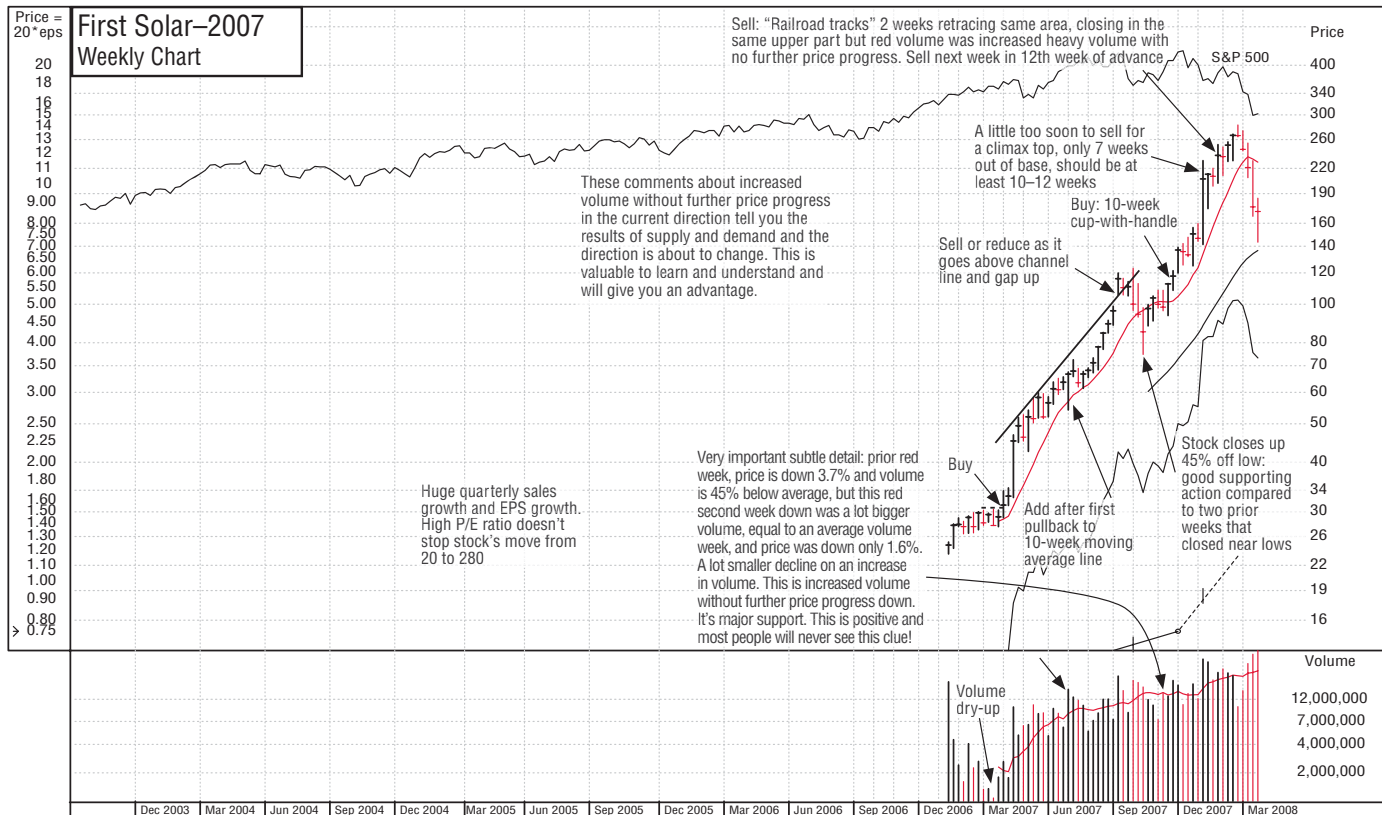
Precision Castparts increased 259% in 115 weeks.



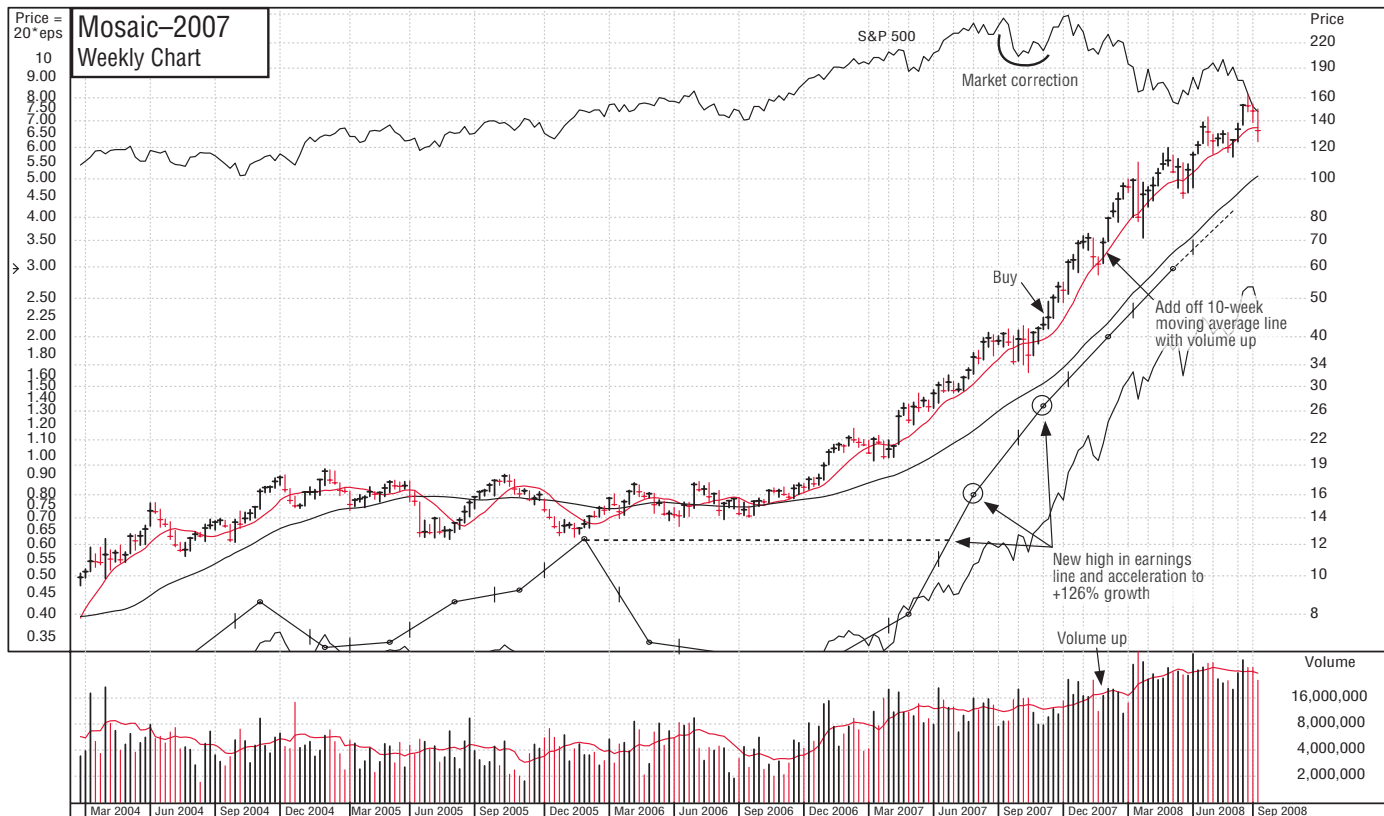
Intuitive Surgical increased 418% in 123 weeks.



Priceline.com increased 320% in 85 weeks.



First Solar increased 807% in 47 weeks.



Mosaic increased 265% in 40 weeks.

How to Read Charts Like a Pro and Improve Your Selection and Timing

In the world of medicine, X-rays, MRIs, and brain scans are “pictures” that doctors study to help them diagnose what’s going on in the human body. EKGs and ultrasound waves are recorded on paper or shown on TV-like monitors to illustrate what’s happening to the human heart.

Similarly, maps are plotted and set to scale to help people understand exactly where they are and how to get to where they want to go. And seismic data are traced on charts to help geologists study which structures or patterns seem most likely to contain oil.

In almost every field, there are tools available to help people evaluate current conditions correctly and receive accurate information. The same is true in investing. Economic indicators are plotted on graphs to assist in their interpretation. A stock’s price and volume history are recorded on charts to help investors determine whether the stock is strong, healthy, and under accumulation or whether it’s weak and behaving abnormally.

Would you allow a doctor to open you up and perform heart surgery if he had not utilized the critical necessary tools? Of course not. That would be just plain irresponsible. However, many investors do exactly that when they buy and sell stocks without first consulting stock charts. Just as doctors would be irresponsible not to use X-rays, CAT scans, and EKGs on their patients, investors are just plain foolish if they don’t learn to interpret the price and volume patterns found on stock charts. If nothing else, charts can tell you when a stock is not acting right and should be sold.

Individual investors can lose a lot of money if they don’t know how to recognize when a stock tops and starts into a significant correction or if they have been depending on someone else who also doesn’t know this.

Chart Reading Basics

A chart records the factual price performance of a stock. Price changes are the result of daily supply and demand in the largest auction marketplace in the world. Investors who train themselves to decode price movements on charts have an enormous advantage over those who either refuse to learn, just don't know any better, or are a bit lazy.

Would you fly in a plane without instruments or take a long cross-country trip in your car without a road map? Charts are your investment road map. In fact, the distinguished economists Milton and Rose Friedman devoted the first 28 pages of their excellent book *Free to Choose* to the power of market facts and the unique ability of prices to provide important and accurate information to decision makers.

Chart patterns, or "bases," are simply areas of price correction and consolidation after an earlier price advance. Most of them (80% to 90%) are created and formed as a result of corrections in the general market. The skill you need to learn in order to analyze these bases is how to diagnose whether the price and volume movements are normal or abnormal. Do they signal strength or weakness?

Major advances occur off strong, recognizable price patterns (discussed later in this chapter). Failures can always be traced to bases that are faulty or too obvious to the typical investor.

Fortunes are made every year by those who take the time to learn to interpret charts properly. Professionals who don't make use of charts are confessing their ignorance of highly valuable measurement and timing mechanisms. To further emphasize this point: I have seen many high-level investment professionals ultimately lose their jobs as a result of weak performance.

When this happens, their poor records are often a direct result of not knowing very much about market action and chart reading. Universities that teach finance or investment courses and dismiss charts as irrelevant or unimportant are demonstrating their complete lack of knowledge and understanding of how the market really works and how the best professionals operate.

As an individual investor, you too need to study and benefit from stock charts. It's not enough to buy a stock simply because it has good fundamental characteristics, like strong earnings and sales. In fact, no *Investor's Business Daily*® reader should ever buy a stock based solely on IBD's proprietary *SmartSelect*® Ratings. A stock's chart must always be checked to determine whether the stock is in a proper position to buy, or whether it is the stock of a sound, leading company but is too far extended in price above a solid basing area and thus should temporarily be avoided.

As the number of investors in the market has increased over recent years, simple price and volume charts have become more readily available. (*Investor's Business Daily* subscribers have free access to 10,000 daily and weekly charts on the Web at Investors.com.) Chart books and online chart services can help you follow hundreds and even thousands of stocks in a highly organized, time-saving way. Some are more advanced than others, offering both fundamental and technical data in addition to price and volume movement. Subscribe to one of the better chart services, and you'll have at your fingertips valuable information that is not easily available elsewhere.

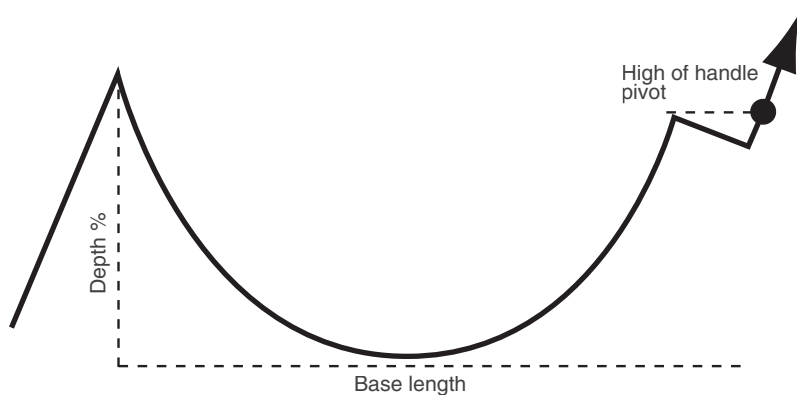
History Repeats Itself: Learn to Use Historical Precedents

As mentioned in the introduction, and as shown on the annotated charts of history's best winners in Chapter 1, our system for selecting winning stocks is based on how the market actually operates, not on my or anyone else's personal opinions or academic theories. We analyzed the greatest winning stocks of the past and discovered they all had seven common characteristics, which can be summarized in the two easy-to-remember words CAN SLIM. We also discovered there were a number of successful price patterns and consolidation structures that repeated themselves over and over again. In the stock market, history repeats itself. This is because human nature doesn't change. Neither does the law of supply and demand. Price patterns of the great stocks of the past can clearly serve as models for your future selections. There are several price patterns you'll want to look for when you're analyzing a stock for purchase. I'll also go over some signals to watch out for that indicate that a price pattern may be faulty and unsound.

The Most Common Chart Pattern: "Cup with Handle"

One of the most important price patterns looks like a cup with a handle when the outline of the cup is viewed from the side. Cup patterns can last from 7 weeks to as long as 65 weeks, but most of them last for three to six months. The usual correction from the absolute peak (the top of the cup) to the low point (the bottom of the cup) of this price pattern varies from around the 12% to 15% range to upwards of 33%. A strong price pattern of any type should always have a clear and definite price uptrend prior to the beginning of its base pattern. You should look for at least a 30% increase in price in the prior uptrend, together with improving relative strength and a very substantial increase in trading volume at some points in the prior uptrend.

In most, but not all, cases, the bottom part of the cup should be rounded and give the appearance of a "U" rather than a very narrow "V." This char-

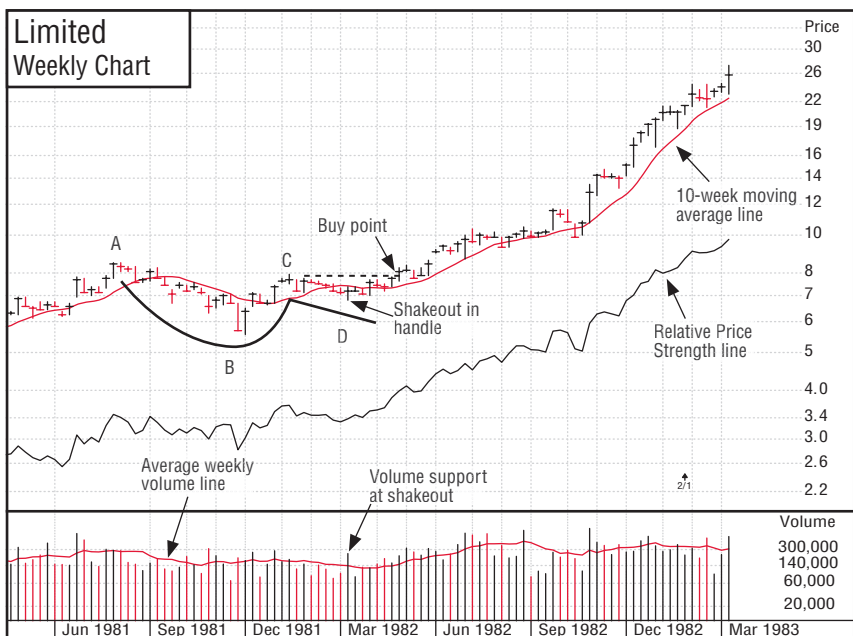
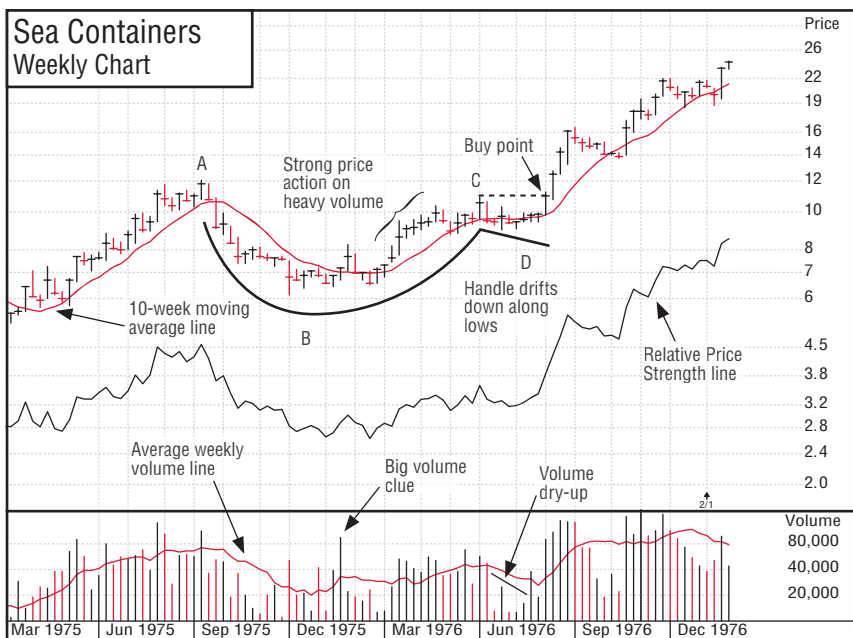


acteristic allows the stock time to proceed through a needed natural correction, with two or three final little weak spells around the lows of the cup. The “U” area is important because it scares out or wears out the remaining weak holders and takes other speculators’ attention away from the stock. A more solid foundation of strong owners who are much less apt to sell during the next advance is thereby established. The accompanying chart from Daily Graphs Online® shows the daily price and volume movements for Apple Computer in February 2004.

It’s normal for growth stocks to create cup patterns during intermediate declines in the general market and to correct $1\frac{1}{2}$ to $2\frac{1}{2}$ times the market averages. Your best choices are generally stocks with base patterns that deteriorate the least during an intermediate market decline. Whether you’re in a bull market or a bear market, stock downturns that exceed $2\frac{1}{2}$ times the market averages are usually too wide and loose and must be regarded with suspicion. Dozens of former high-tech leaders, such as JDS Uniphase, formed wide, loose, and deep cup patterns in the second and third quarters of 2000. These were almost all faulty, failure-prone patterns signaling that the stocks should have been avoided when they attempted to break out to new highs.

A few volatile leaders can plunge 40% or 50% in a bull market. Chart patterns correcting more than this during bull markets have a higher failure rate if they try to make new highs and resume their advance. The reason? A downswing of over 50% from a peak to a low means a stock must increase more than 100% from its low to get back to its high. Historical research shows stocks that make new price highs after such huge moves tend to fail 5% to 15% beyond their breakout prices. Stocks that come straight off the bottom into new highs off cups can be more risky because they had no pullbacks. Deep 50% to 75% cup-with-handle bases worked in 2009 since they were made by a 58% drop in the S&P 500.

Sea Containers was a glowing exception. It descended about 50% during an intermediate decline in the 1975 bull market. It then formed a perfectly shaped cup-with-handle price structure and proceeded to increase 554% in



the next 101 weeks. This stock, with its 54% earnings growth rate and its latest quarterly results up 192%, was one of several classic cup-with-handle stocks that I presented to Fidelity Research & Management in Boston during a monthly meeting in early June 1975. Upon seeing such big numbers, one of the portfolio managers was instantly interested.

As you can see by this example, some patterns that have corrected 50% to 60% or more coming out of an intermediate bull market decline or a major bear market can succeed. (See the charts for Sea Containers and The Limited.) In most cases, the percent of decline is a function of the severity of the general market decline and the tremendous extent of the stock's prior price run-up.

Basic Characteristics of a Cup's Handle Area

The formation of the handle area generally takes more than one or two weeks and has a downward price drift or "shakeout" (where the price drops below a prior low point in the handle made a few weeks earlier), usually near the end of its down-drifting price movement. Volume may dry up noticeably near the lows in the handle's price pullback phase. During a bull market, volume in the majority of cases should not pick up during a correction in the handle, although there have been some exceptions.

Although cups without handles have a somewhat higher failure rate, many stocks can advance successfully without forming a handle. Also, some of the more volatile technology names in 1999 formed handles of only one or two weeks before they began their major price advances.

When handles do occur, they almost always form in the upper half of the overall base structure, as measured from the absolute peak of the entire base to the absolute low of the cup. The handle should also be above the stock's 10-week moving average price line. Handles that form in the lower half of an overall base or completely below the stock's 10-week line are weak and failure-prone. Demand up to that point has not been strong enough to enable the stock to recover more than half its prior decline.

Additionally, handles that consistently wedge up (drift upward along their price lows or just go straight sideways along their lows rather than drifting down) have a much higher probability of failing when they break out to new highs. This upward-wedging behavior along low points in the handle doesn't let the stock undergo the needed shakeout or sharp price pullback after having advanced from the low of the base into the upper half of the pattern. This high-risk trait tends to occur in third- or fourth-stage bases, in laggard stock bases, or in very active market leaders that become too widely followed and therefore too obvious. You should beware of wedging handles.

A price drop in a proper handle should be contained within 8% to 12% of its peak during bull markets unless the stock forms a very large cup, as in

the rather unusual case of Sea Containers in 1975. Downturns in handles that exceed this percentage during bull markets look wide and erratic and in most cases are improper and risky. However, if you're in the last shake-out area of a bear market bottom, the unusual general market weakness will cause some handle areas to quickly decline around 20% to 30%, but the price pattern can still be sound if the general market then follows through on the upside, creating a new major uptrend. (See Chapter 9, "M = Market Direction: How You Can Determine It.")

Constructive Patterns Have Tight Price Areas

There should also be at least some tight areas in the price patterns of stocks under accumulation. On a weekly chart, tightness is defined as small price variations from high to low for the week, with several consecutive weeks' prices closing unchanged or remarkably near the previous week's close. If the base pattern has a wide spread between the week's high and low points every week, it's been constantly in the market's eye and frequently will not succeed when it breaks out. However, amateur chartists typically will not notice the difference, and the stock can run up 5% to 15%, drawing in less-discriminating traders, before it breaks badly and fails.

Find Pivot Points and Watch "Volume Percent Change"

When a stock forms a proper cup-with-handle chart pattern and then charges through an upside buy point, which Jesse Livermore referred to as the "pivot point" or "line of least resistance," the day's volume should increase at least 40% to 50% above normal. During major breakouts, it's not uncommon for new market leaders to show volume spikes 200%, 500%, or 1,000% greater than the average daily volume. In almost all cases, it's professional institutional buying that causes the big, above-average volume increases in the better-priced, better-quality growth-oriented stocks at pivot breakouts. A full 95% of the general public is usually afraid to buy at such points because it's scary and it seems risky and rather absurd to buy stocks at their highest prices.

Your objective isn't to buy at the cheapest price or near the low, but to begin buying at exactly the right time, when your chances for success are greatest. This means that you have to learn to wait for a stock to move up and trade at your buy point before you make an initial commitment. If you work and cannot watch the market constantly, small quote devices or quotes available on cell phones and Web sites will help you stay on top of potential breakout points.

The winning individual investor waits to buy at these precise pivot points. This is where the real move generally starts and all the exciting action begins. If you try to buy before this point, you may be premature. In many cases the stock will never get to its breakout point, but rather will stall or actually decrease in price. You want a stock to prove its strength to you before you invest in it. Also, if you buy at more than 5% to 10% past the precise buy point, you are buying late and will more than likely get caught in the next price correction. Your automatic 8% loss-cutting rule (see Chapter 10, “When You Must Sell and Cut Every Loss . . . Without Exception”) will then force you to sell because the stock was extended in price and didn’t have enough room to go through a perfectly normal sharp but minor correction. So don’t get into the bad habit of chasing stocks up too high.

Pivot buy points in correct chart base patterns are not typically based on a stock’s old high price. Most of them occur at 5% to 10% below the prior peak. The peak price in the handle area is what determines most buy points, and this is almost always somewhat below the base’s actual high. This is very important to remember. If you wait for an actual new high price, you will often buy too late. Sometimes you can get a slight head start by drawing a downtrend line from the overall pattern’s absolute peak downward across the peak where the stock begins building the handle. Then begin your purchase when the trend line is broken on the upside a few weeks later. However, you have to be right in your chart and stock analysis to get away with this.

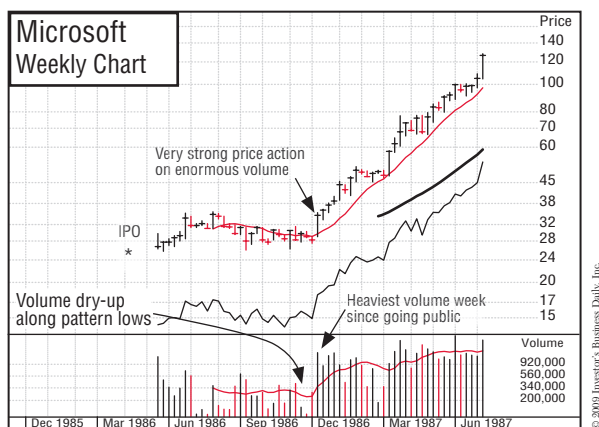
Look for Volume Dry-Ups Near the Lows of a Price Pattern

Nearly all proper bases will show a dramatic drying up of volume for one or two weeks along the very low of the base pattern and in the low area or few last weeks of the handle. This means that all of the selling has been exhausted and there is very little stock coming into the marketplace. Healthy stocks that are under accumulation almost always show this symptom. The combination of tightness in prices (daily or weekly price closes being very near each other) and dried-up volume at key points is generally quite constructive.

Big Volume Clues Are Valuable

Another clue that is valuable to the trained chart specialist is the occurrence of big daily and weekly volume spikes. Microsoft is an example of an outstanding stock that flashed heavy accumulation just before a huge run-up.

Weeks of advancing prices on heavy volume, followed in other weeks by extreme volume dry-ups, are also a very constructive sign. If you use a Daily



Graphs Online chart service in conjunction with the weekly graphs, you'll be able to see unusual trading activity that sometimes happens on only one day. The day Microsoft broke out at its $31\frac{1}{2}$ buy point, its volume was 545% above average, signaling really important institutional buying. It then had a 13-year bull run from a split-adjusted 10 cents to \$53.98. How's that for a big percentage move?

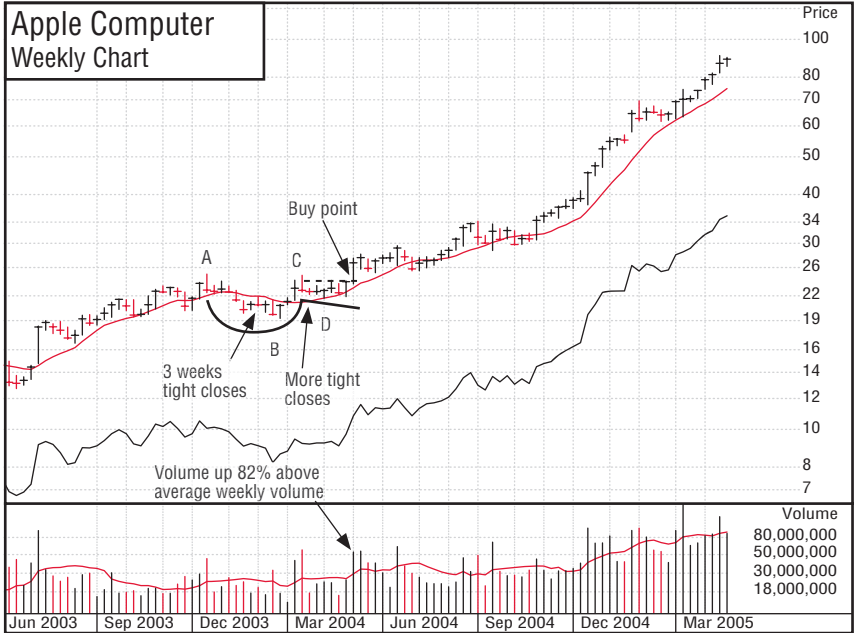
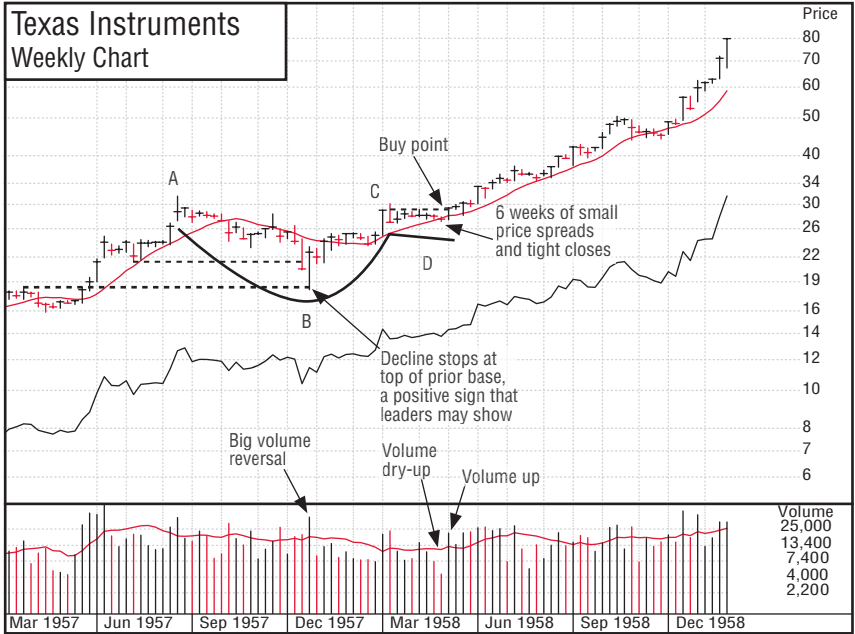
Volume is a remarkable subject that is worthy of careful study. It can help you recognize whether a stock is under accumulation (institutional buying) or distribution (institutional selling). Once you acquire this skill, you won't have to rely on the personal opinions of analysts and supposed experts. Big volume at certain key points is indispensable.

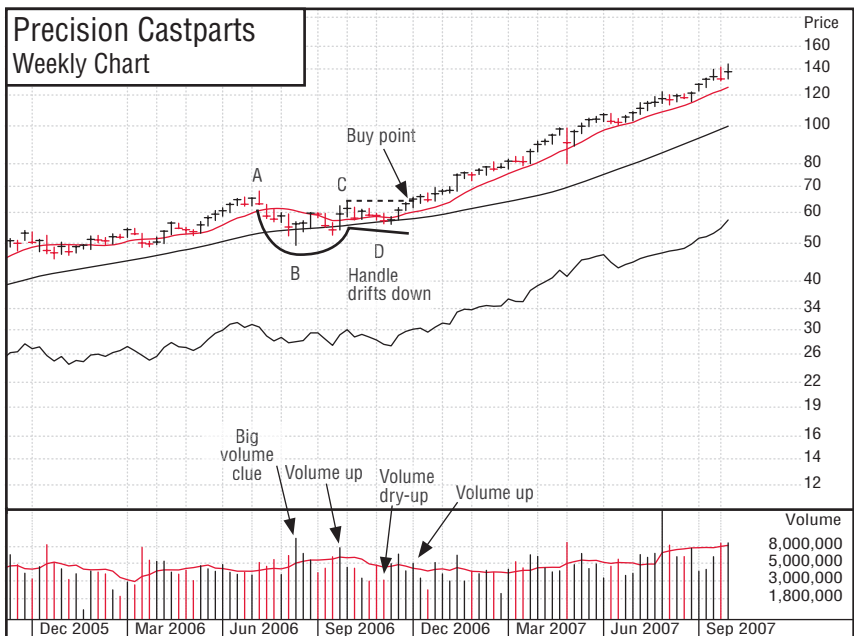
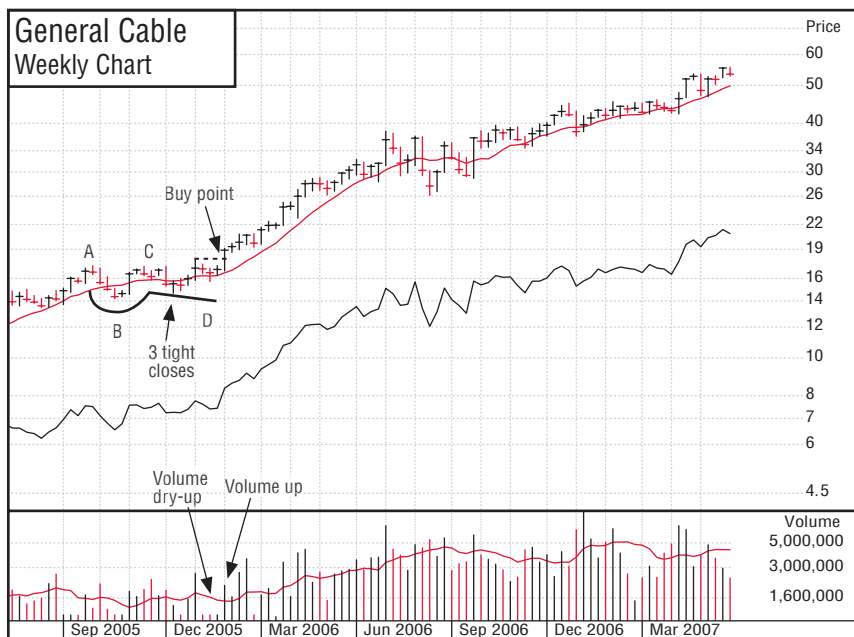
Volume is your best measure of supply and demand and institutional sponsorship—two vital ingredients in successful stock analysis. Learn how to use charts to time your purchases correctly. Making buys at the wrong time or, worse, buying stocks that are not under accumulation or that have unsound, faulty price patterns is simply too costly.

The next time you consider buying a stock, check its weekly volume. It's usually a constructive sign when the number of weeks that the stock closes up in price on above-average weekly volume outnumbers the number of weeks that it closes down in price on above-average volume while still in its chart base.

A Few Normal-Size Cups with Handles

Texas Instruments, Apple, General Cable, and Precision Castparts were all similar-size patterns in length and depth. Can you recognize the similarity between Apple and Precision Castparts? As you learn to do this with greater skill, you will in the future be able to spot many cups with handles just like these past winners.





The Value of Market Corrections

Since 80% to 90% of price patterns are created during market corrections, you should never get discouraged and give up on the stock market's potential during intermediate-term sell-offs or short or prolonged bear markets. America always comes back because of its inventors and entrepreneurs and the total freedom and unlimited opportunity that do not exist in communist or dictator-controlled countries.

Bear markets can last as little as three, six, or nine months or as long as two or, in very rare cases, three years. If you follow the sell rules in this book carefully, you will sell and nail down most of your profits, cut short any losses, raise significant cash, and move off margin (borrowed money) in the early stages of each new bear market (see the success stories at the end of the book).

In fact, *Investor's Business Daily* conducted four surveys in late 2008 that indicated that about 60% of IBD subscribers used our rules to sell and raise cash in December 2007 or June 2008 and thereby preserved most of their capital prior to the more serious decline in late 2008 that resulted from the subprime loan debacle.

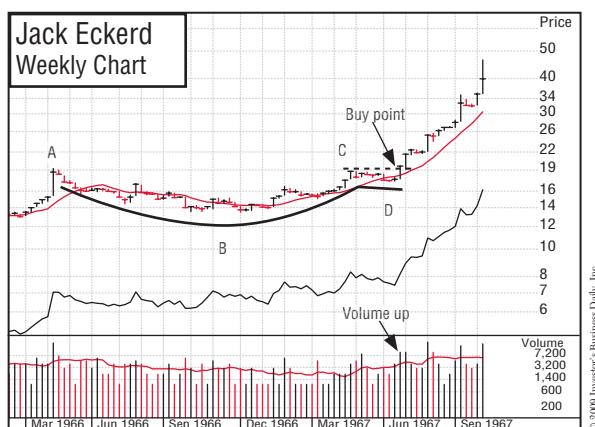
Even if you sell out completely and move to cash, you never want to throw in the towel on stock investing because bear markets create new bases in new stocks, some of which could be the next cycle's 1,000% winners. You don't foolishly give up while the greatest opportunities of a lifetime are setting up and may sooner or later be just around the corner.

A bear market is the time to do a postanalysis of your prior decisions. Plot on daily or weekly charts exactly where you bought and sold all the stocks you traded in the past year. Study your decisions and write out some new rules that will let you avoid the mistakes you made in the past cycle. Then study several of the biggest winners that you missed or mishandled. Develop some rules to make sure that you buy the real leaders and handle them right in the next bull market cycle. They will be there, and this is the time to be watching for them as they begin to form bases. The question is whether *you* will be there with a carefully thought-through game plan to totally capitalize on them.

Other Price Patterns to Look For

How to Spot a "Saucer-with-Handle" Price Pattern

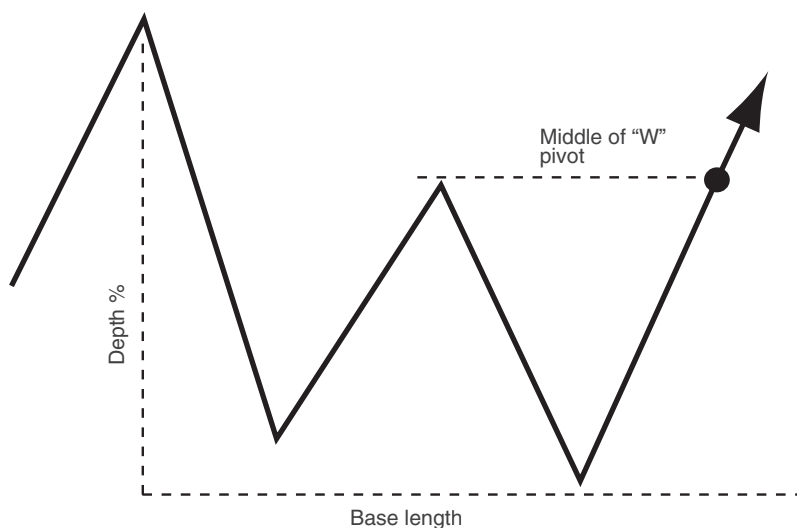
A "saucer with handle" is a price pattern similar to the cup with handle except that the saucer part tends to stretch out over a longer period of time, making the pattern shallower. (If the names "cup with handle" and "saucer with handle" sound unusual, consider that for years you have recognized and called



certain constellations of stars the “Big Dipper” and the “Little Dipper.”) Jack Eckerd in April 1967 was an example of the saucer-with-handle base.

Recognizing a “Double-Bottom” Price Pattern

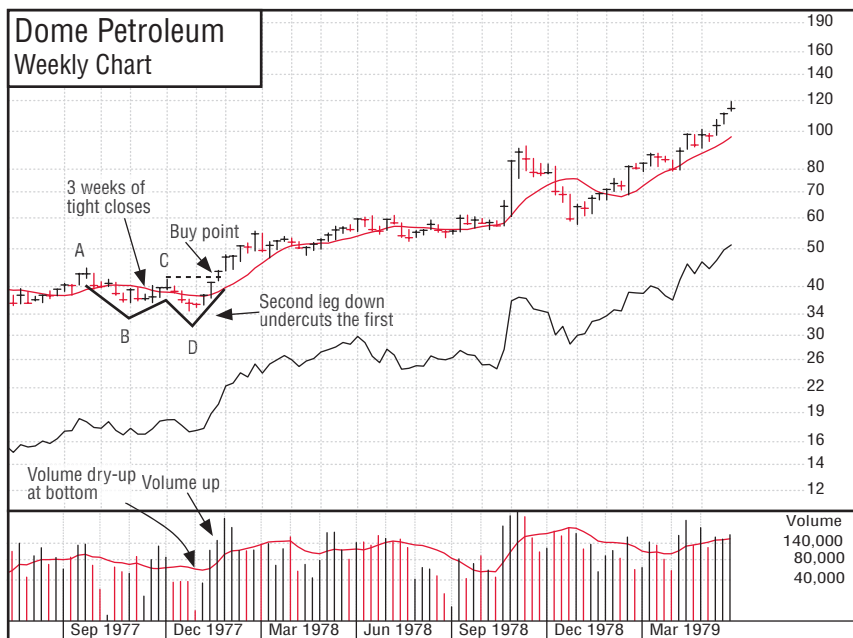
A “double-bottom” price pattern looks like the letter “W.” This pattern also doesn’t occur quite as often as the cup with handle, but it still occurs frequently. It is usually important that the second bottom of the W match the price level (low) of the first bottom or, as in almost all cases, clearly undercut it by one or two points, thereby creating a shakeout of weaker investors. Fail-

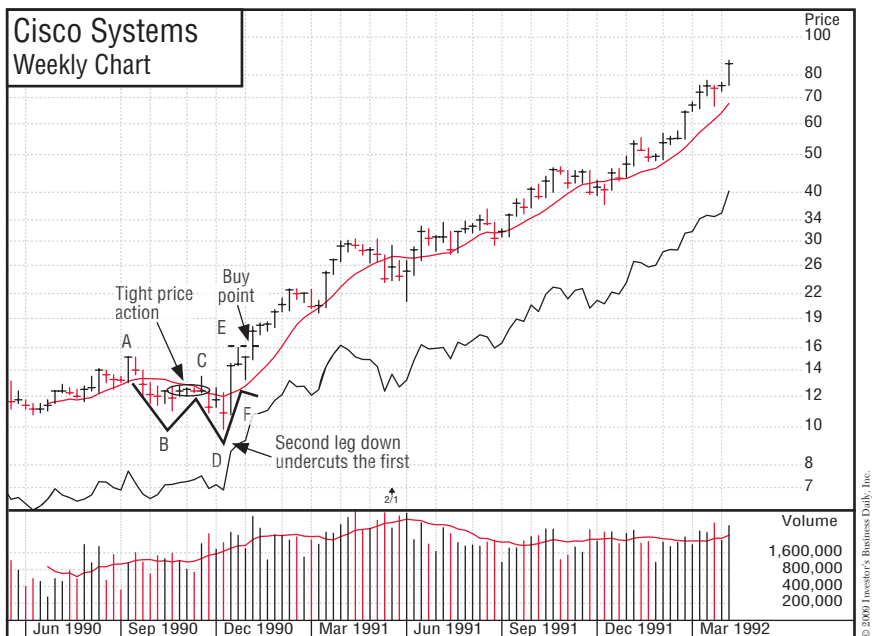
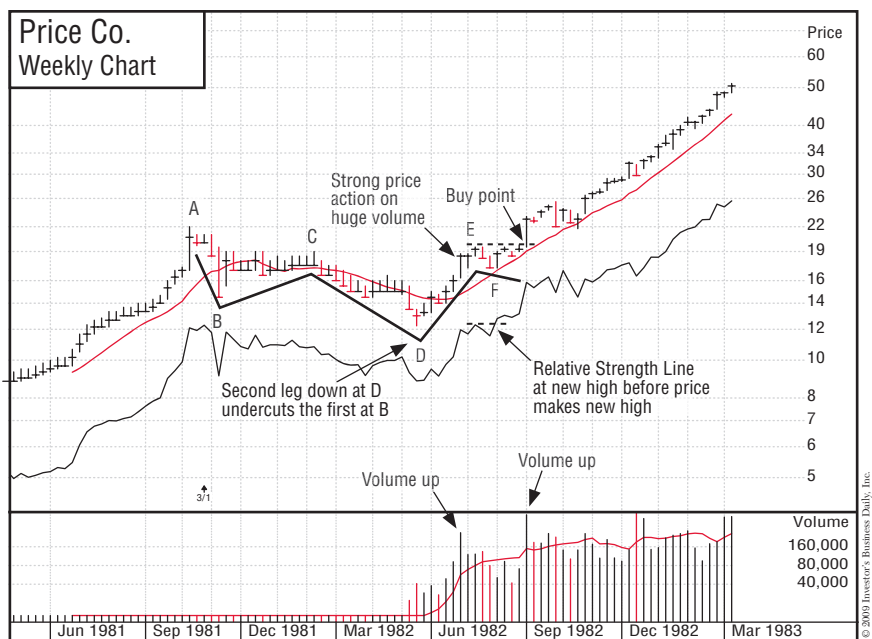


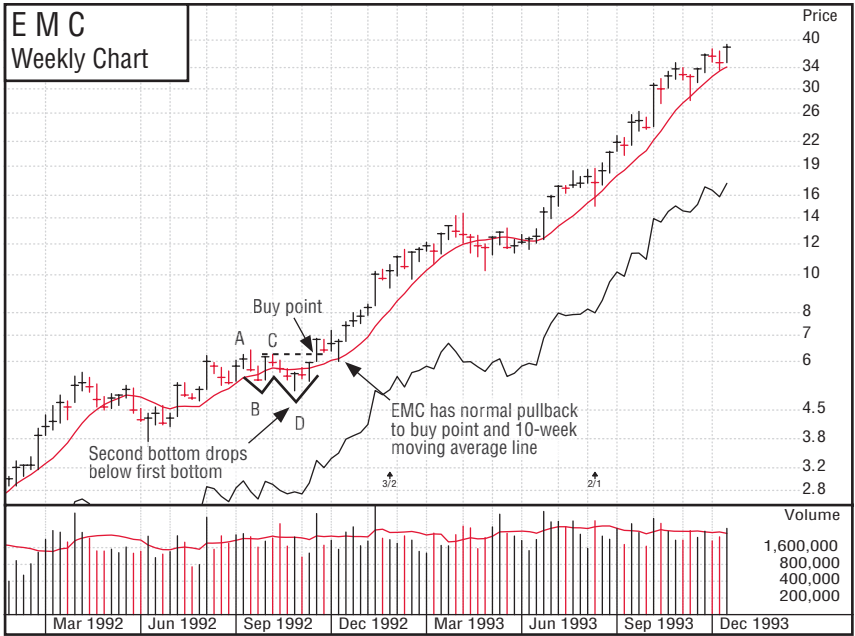
ure to undercut may create a faulty, more failure-prone “almost” double bottom. Double bottoms may also have handles, although this is not essential.

The depth and horizontal length of a double bottom are similar to those of the cup formation. The pivot buy point in a double bottom is located on the top right side of the W, where the stock is coming up after the second leg down. The pivot point should be equal in price to the top of the middle peak of the W, which should stop somewhere a little below the pattern's peak price. If the double bottom has a handle, then the peak price of the handle determines the pivot buy point. See the accompanying charts for Dome Petroleum, Price Co., and Cisco Systems for outstanding examples of double-bottom price patterns found during 1977, 1982, and 1990. Some later examples are EMC, NVR, and eBay.

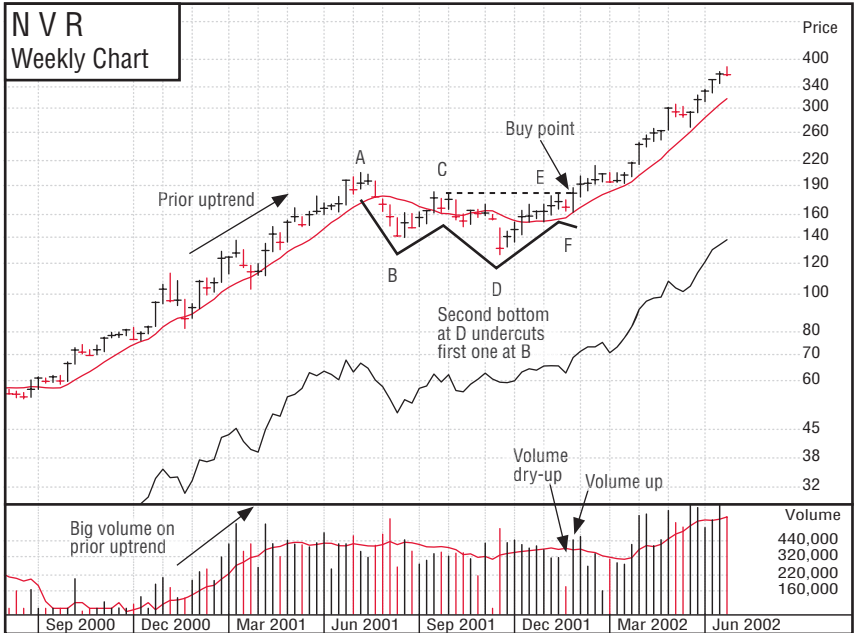
For double-bottom patterns, the following symbols apply: A = beginning of base; B = bottom of first leg; C = middle of W that sets the buy point; D = bottom of second leg. If the double-bottom pattern has a handle, then E = top of the handle (sets the price of the buy point that occurs several weeks later) and F = bottom of the handle.



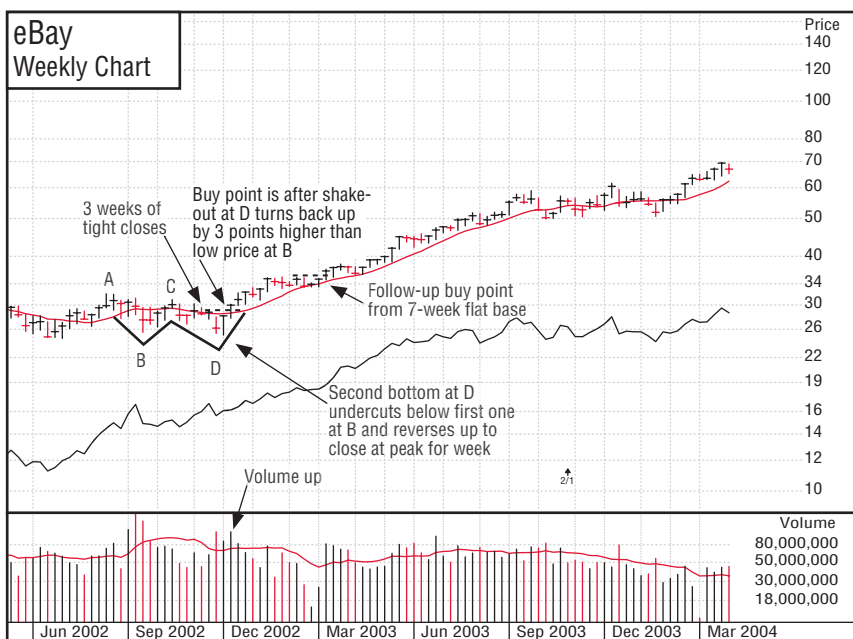




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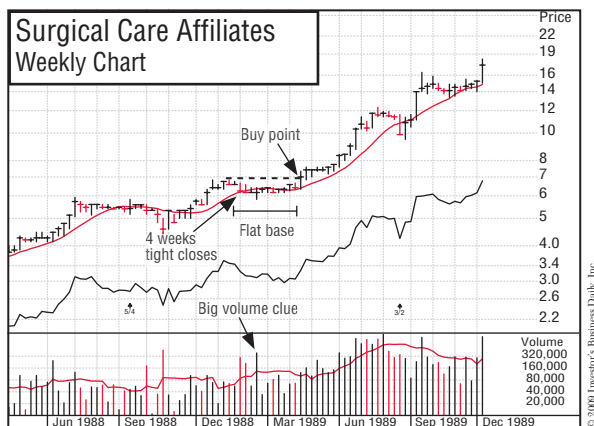


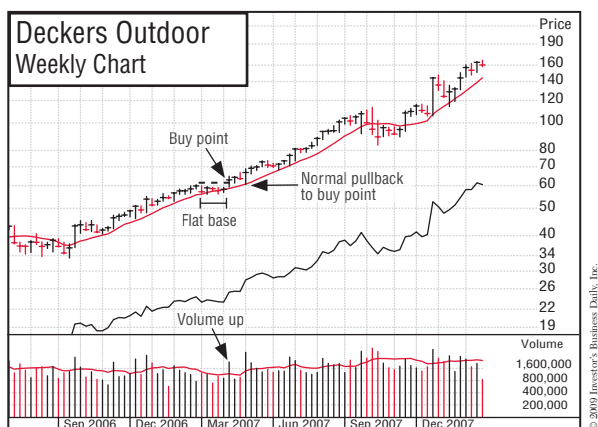
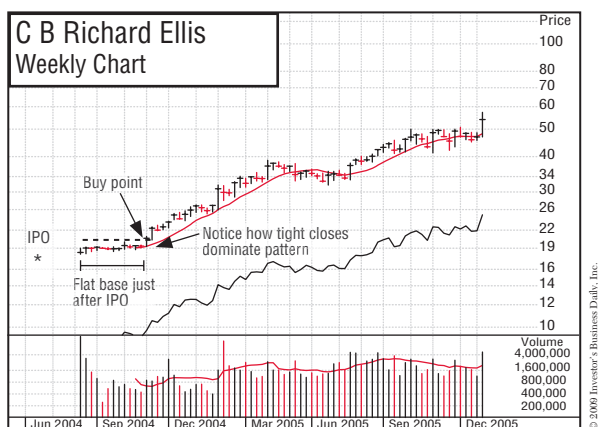
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Definition of a "Flat-Base" Price Structure

A flat base is another rewarding price structure. It is usually a second-stage base that occurs after a stock has advanced 20% or more off a cup with handle, saucer with handle, or double bottom. The flat base moves straight sideways in a fairly tight price range for at least five or six weeks, and it does not correct more than 10% to 15%. Standard Oil of Ohio in May 1979, Smith-Kline in March 1978, and Dollar General in 1982 are good examples of flat

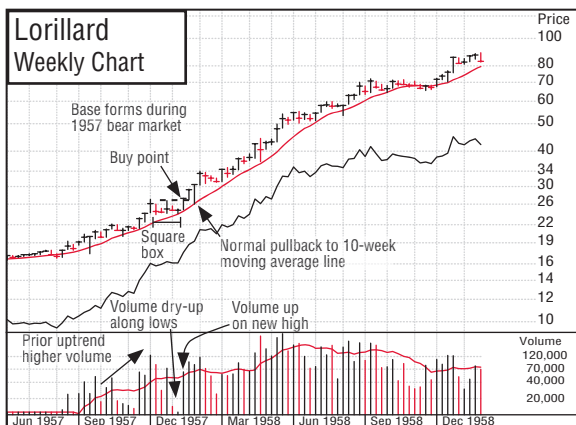




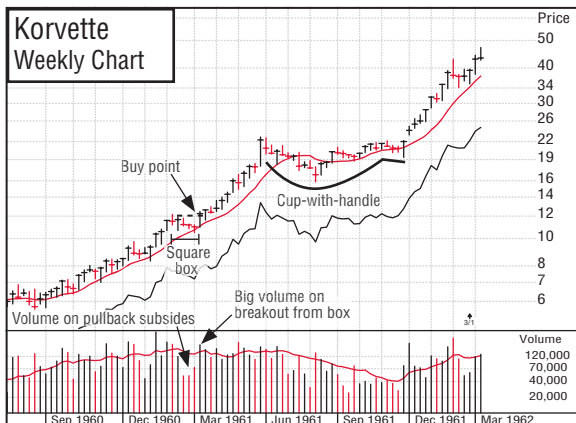
bases. Pep Boys in March 1981 formed a longer flat base. If you miss a stock's initial breakout from a cup with handle, you should keep your eye on it. In time it may form a flat base and give you a second opportunity to get on board. Here are a few more recent examples: Surgical Care Affiliates, CB Richard Ellis, and Deckers Outdoor.

Here's a New Base We've Dubbed a Square Box

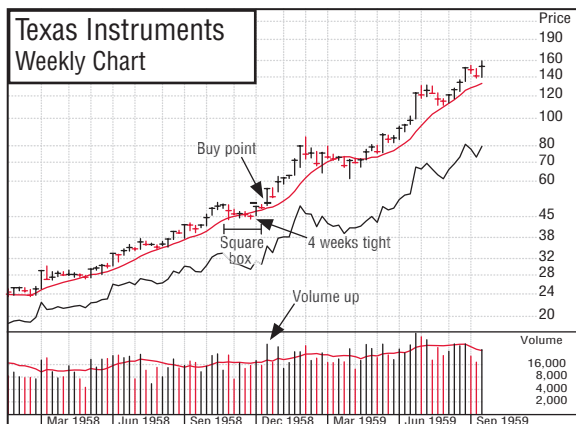
After moving up from a cup with handle or double bottom, this formation typically lasts four to seven weeks; doesn't correct too much, usually 10% to 15%; and has a square, boxy look. I've noted this over recent years, but finally we've studied, measured, and classified it. Here are some examples: Lorillard, Corvette, Texas Instruments, Home Depot, Dell, and Taro. The dashed line shows the buy point.



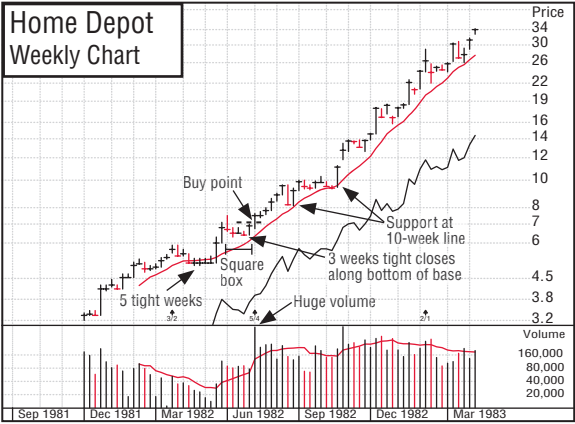
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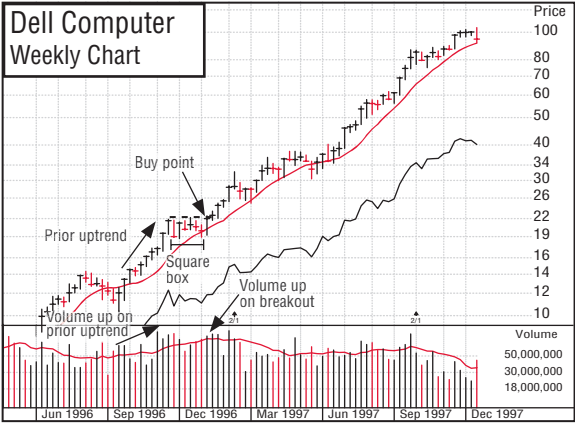
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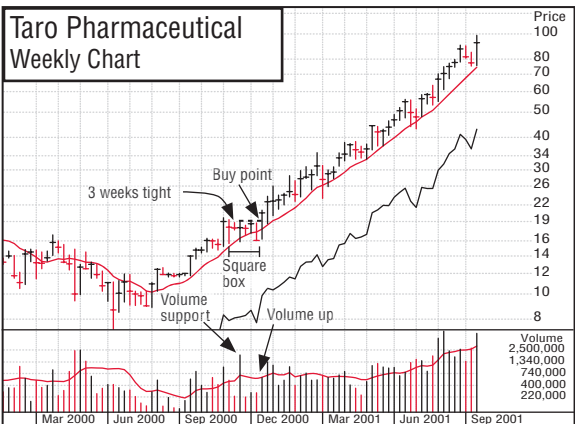
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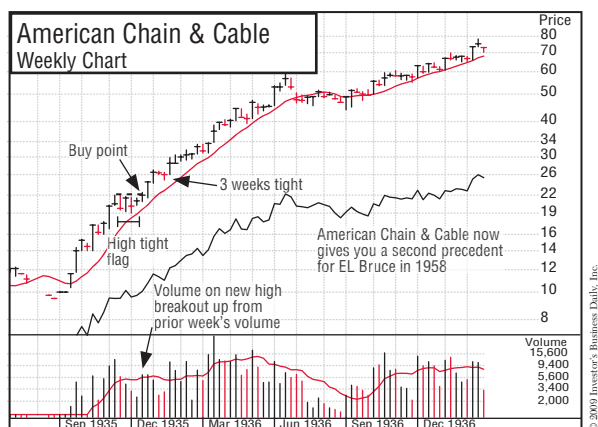
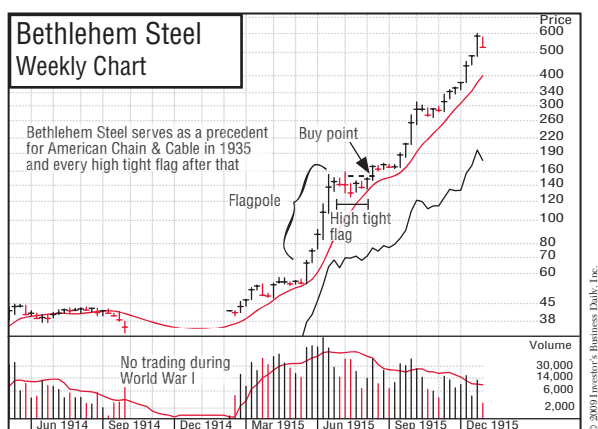


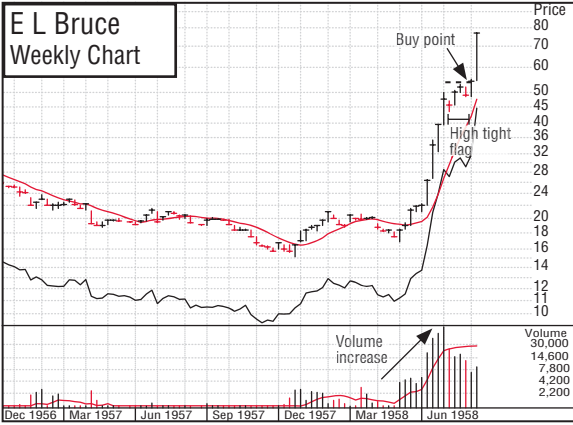
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High, Tight Flags Are Rare

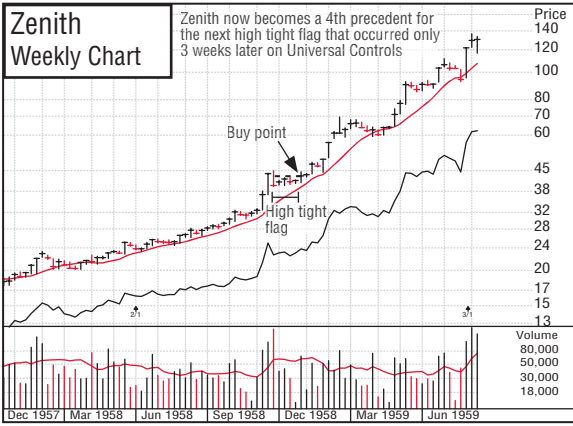
A “high, tight flag” price pattern is rare, occurring in no more than a few stocks during a bull market. It begins with the stock moving generally 100% to 120% in a very short period of time (four to eight weeks). It then corrects sideways no more than 10% to 25%, usually in three, four, or five weeks.

This is the strongest of patterns, but it’s also very risky and difficult to interpret correctly. Many stocks can skyrocket 200% or more off this formation. (See the charts for Bethlehem Steel, May 1915; American Chain & Cable, October 1935; E. L. Bruce, June 1958; Zenith, October 1958; Universal Controls, November 1958; Certain-teed, January 1961; Syntex, July 1963; Rollins, July 1964; Simmonds Precision, November 1965; Accustaff, January 1995; Emulex, October 1999; JDS Uniphase, October 1999; Qualcomm, December 1999; Taser International, November 2003; and Google, September 2004. Each earlier pattern serves as a precedent for each later pattern, so study them carefully.

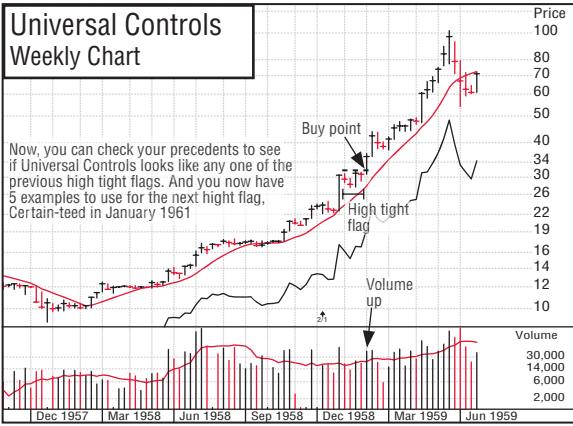




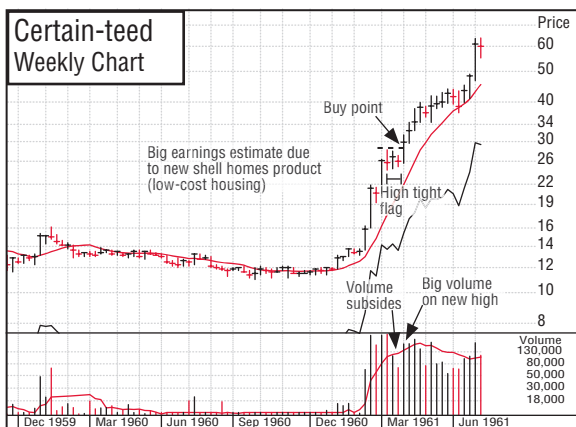
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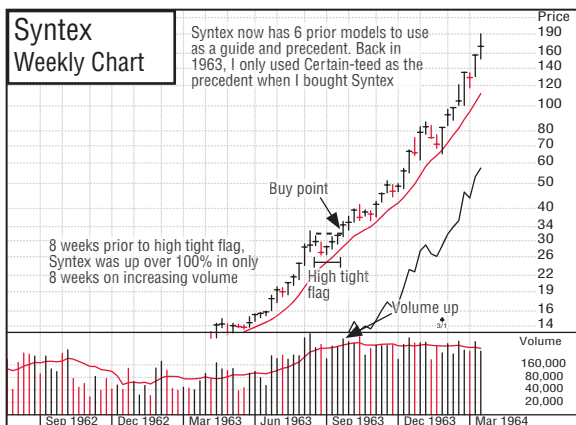
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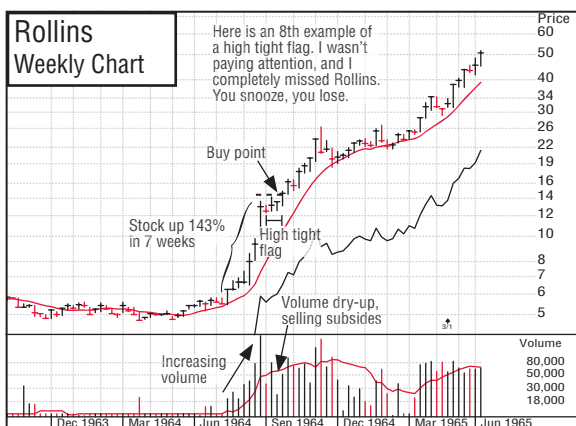
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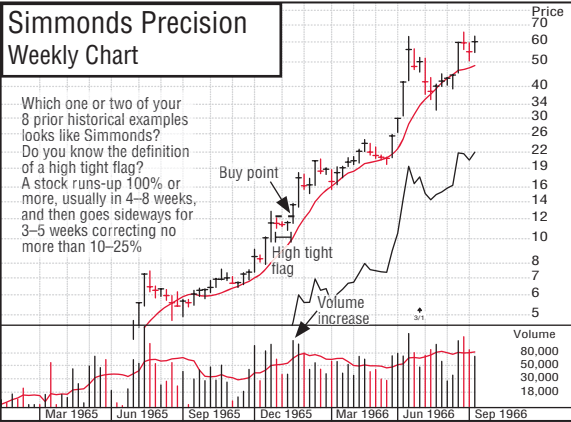
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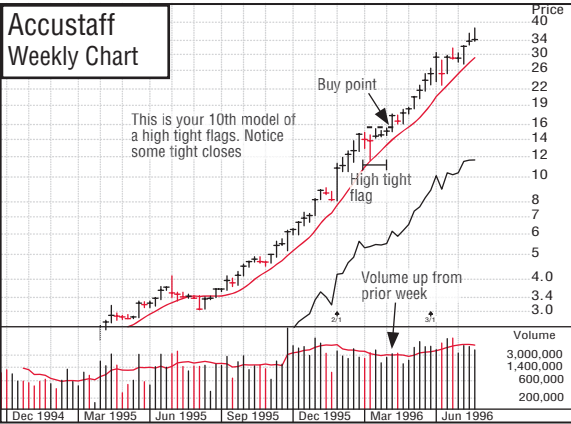
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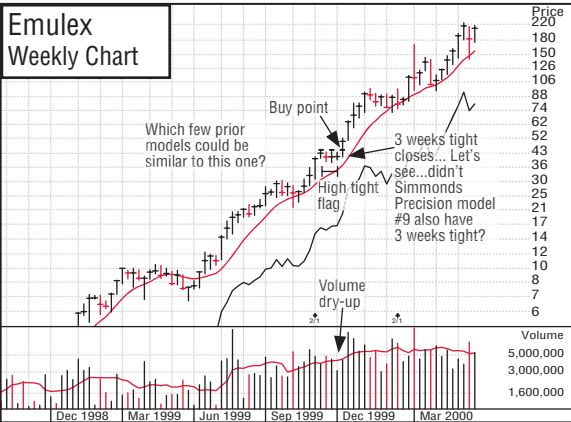
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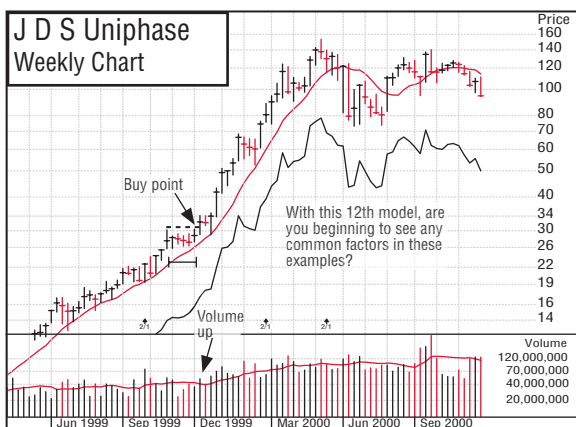
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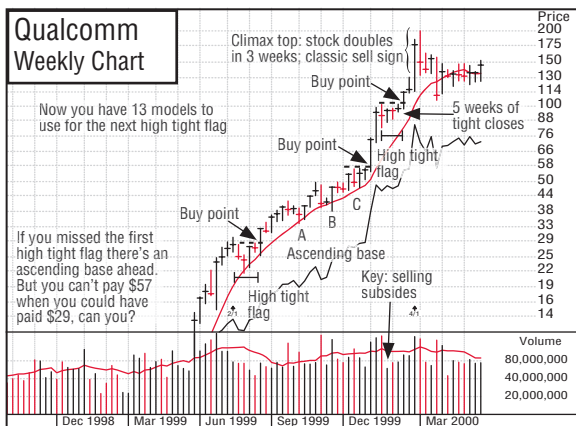
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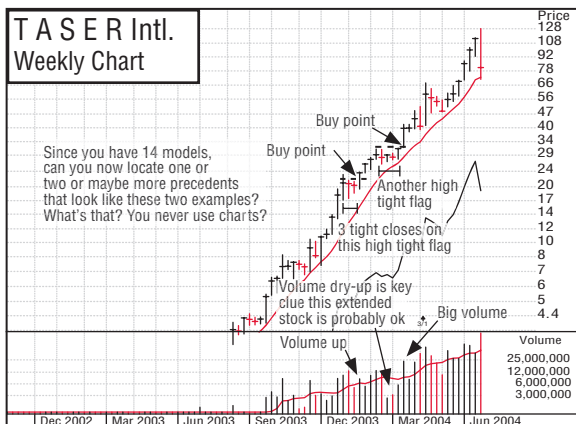
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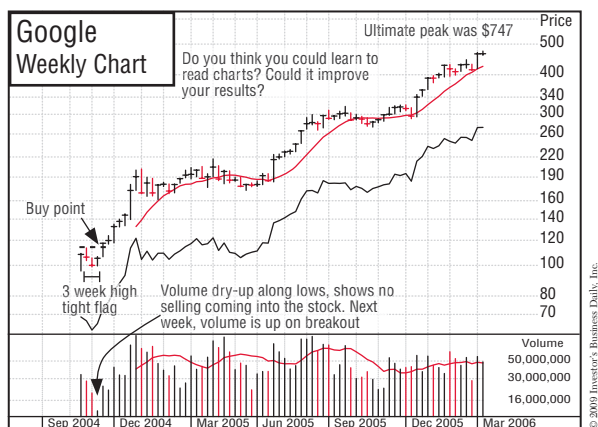
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The E. L. Bruce pattern in the second quarter of 1958, at around \$50, provided a perfect chart pattern precedent for the Certain-teed advance that occurred in 1961. Certain-teed, in turn, became the chart model that I used to buy my first super winner, Syntex, in July 1963.

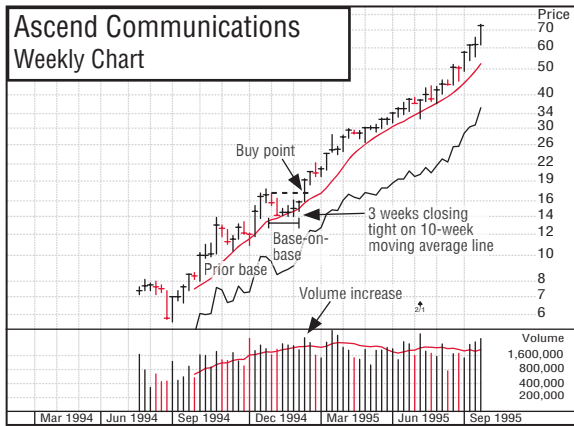
What Is a Base on Top of a Base?

During the latter stages of a bear market, a seemingly negative condition flags what may be aggressive new leadership in the new bull phase. I call this unusual case a “base on top of a base.”

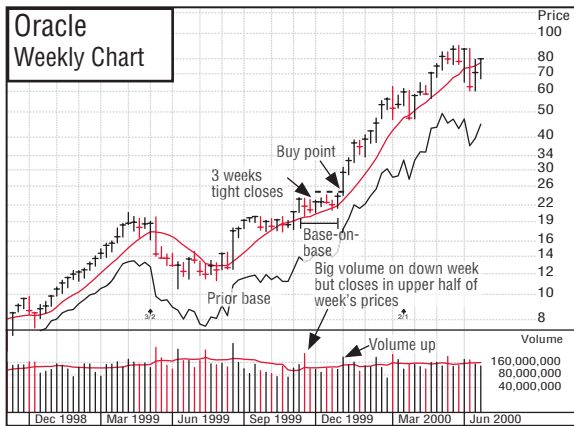
What happens is that a powerful stock breaks out of its base and advances, but is unable to increase a normal 20% to 30% because the general market begins another leg down. The stock therefore pulls back in price and builds a second back-and-forth price consolidation area just on top of its previous base while the general market averages keep making new lows.

When the bearish phase in the overall market ends, as it always does at some point, this stock is apt to be one of the first to emerge at a new high en route to a huge gain. It's like a spring that is being held down by the pressure of a heavy object. Once the object (in this case, a bear market) is removed, the spring is free to do what it wanted to do all along. This is another example of why it's foolhardy to get upset and emotional with the market or lose your confidence. The next big race could be just a few months away.

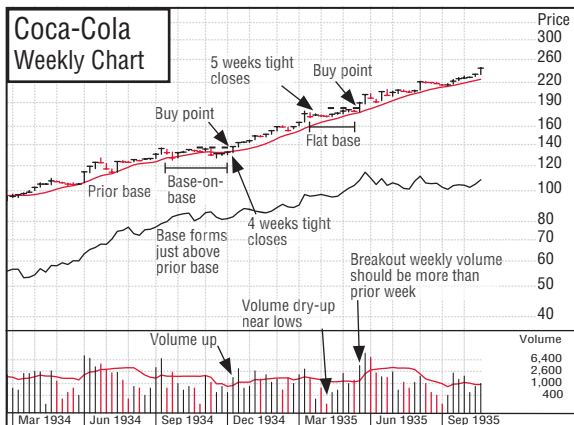
Two of our institutional services firm's best ideas in 1978—M/A-Com and Boeing—showed base-on-top-of-a-base patterns. One advanced 180%, the other 950%. Ascend Communications and Oracle were other examples of a base on top of a base. After breaking out at the bear market bottom of December 1994, Ascend bolted almost 1,500% in 17 months. Oracle repeated the same base-on-base pattern in October 1999 and zoomed nearly 300%. Coming out of the Depression in 1934, Coca-Cola did the same thing.



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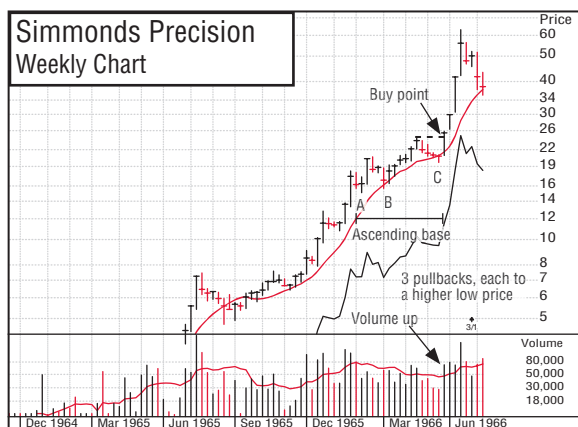
Ascending Bases

Ascending bases, like flat bases, occur midway along a move up after a stock has run up off an earlier base. They have three 10% to 20% pullbacks with each low in price during the sell-off being higher than the preceding one, which is why I call them ascending bases.

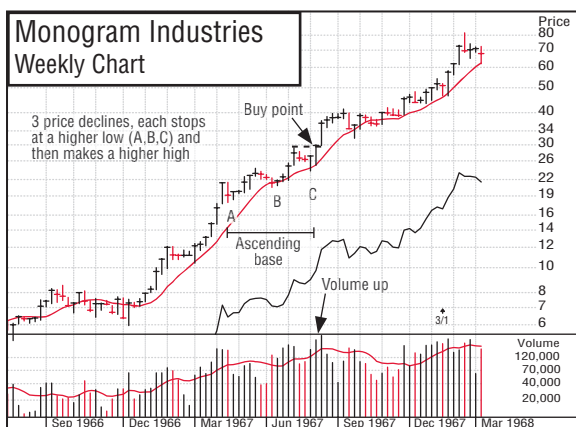
Each pullback occurs due to the general market declining at the time.

Boeing formed a 13-week ascending base in the second quarter of 1954 and then doubled in price. Redman Industries, a builder of mobile homes, had an 11-week ascending base in the first quarter of 1968 and proceeded to increase 500% in just 37 weeks. America Online created the same type of base in the first quarter of 1999 and resumed what turned out to be a 500% run-up from the breakout of a 14-week cup with handle in October 1998.

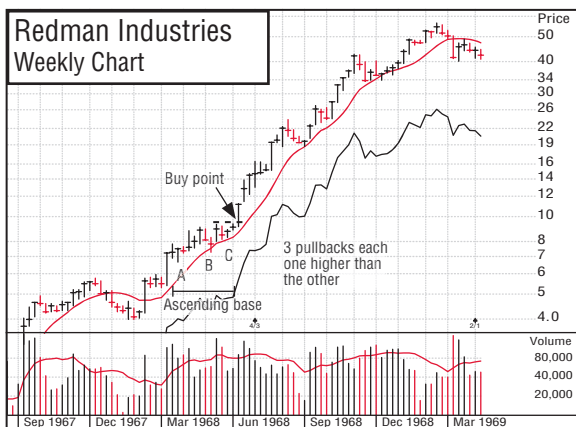
So you see, history does repeat itself. The more historical patterns you learn to recognize, the more money you should be able to make in future markets. (See chart examples in Chapter 1, and also Simmonds Precision, Monogram Industries, Redman Industries, America Online, and Titanium Metals.) The buy point is as soon as the stock makes a new price high after the third 10% to 20% pullback.



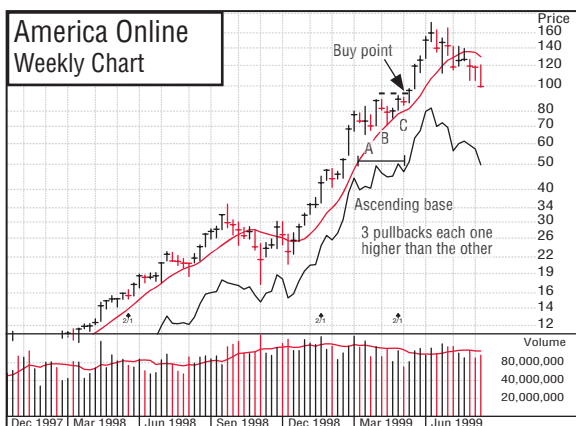
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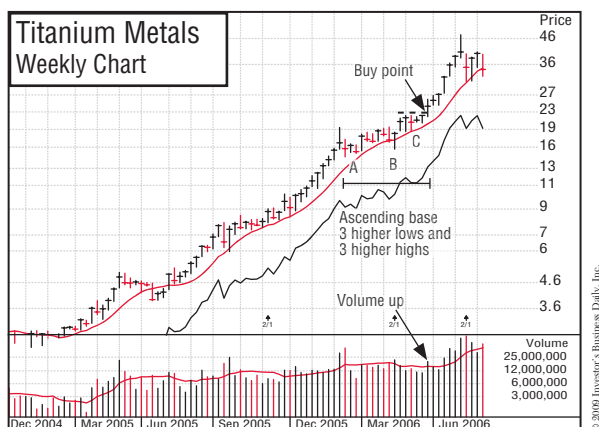
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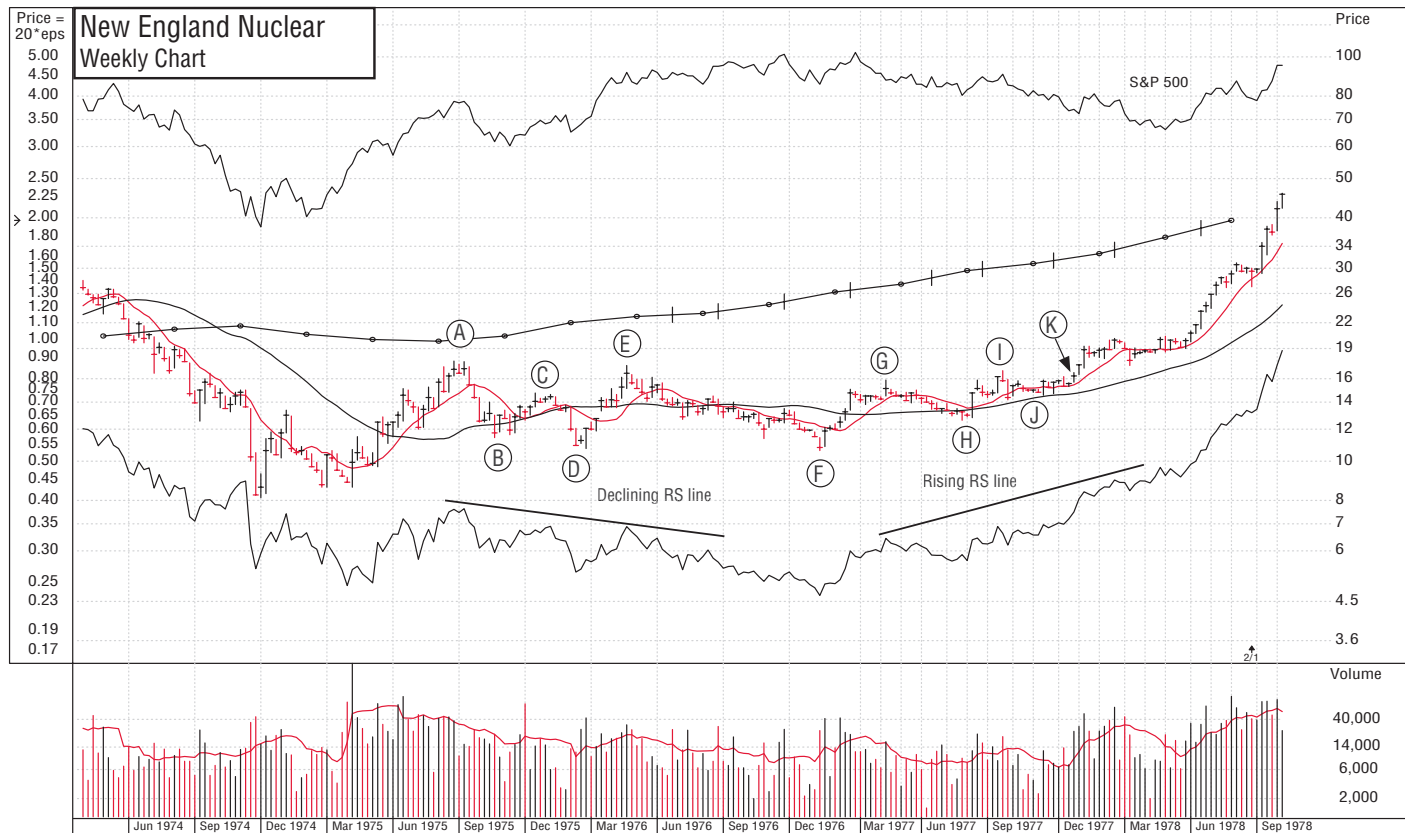
Wide-and-Loose Price Structures Are Failure Prone

Wide-and-loose-looking charts usually fail but can tighten up later. New England Nuclear and Houston Oil & Minerals are two cases of stocks that tightened up following wide, loose, and erratic price movements. I cite them because I missed both of them at the time. It's always wise to review big winners that you missed to find out why you didn't recognize them when they were exactly right and ready to soar.

New England Nuclear formed a wide, loose, and faulty price pattern that looked like a double bottom from points A, B, C, D, and E. It declined about 40% from the beginning at point A to point D. That was excessive, and it took too much time—almost six months—to hit bottom. Note the additional clue provided by the declining trend of its relative strength line (RS) throughout the faulty pattern. Buying at point E was wrong. The handle was also too short and did not drift down to create a shakeout. It wedged up along its low points.

New England Nuclear then formed a second base from points E to F to G. But if you tried to buy at point G, you were wrong again. It was premature because the price pattern was still wide and loose. The move from point E to point F was a prolonged decline, with relative strength deteriorating badly. The rise straight up from the bottom at point F to the bogus breakout point G was too fast and erratic, taking only three months. Three months of improving relative strength versus the prior 17 months of decline weren't enough to turn the previous poor trend into a positive one.

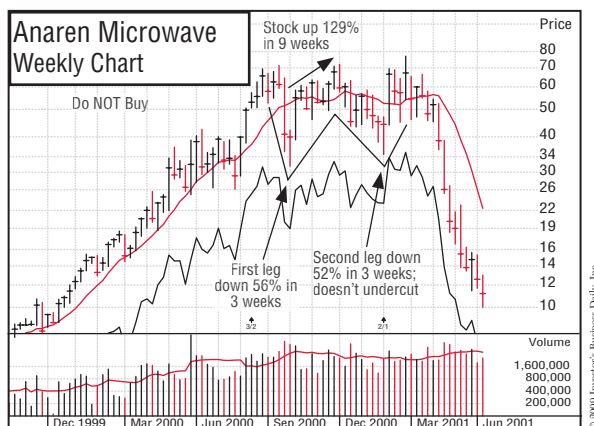
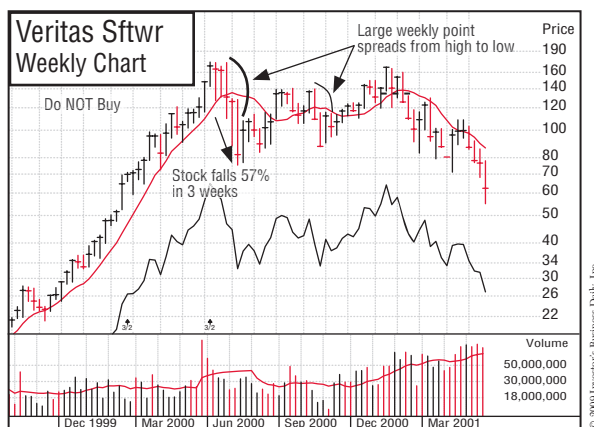
The stock then declined from point G to point H to form what appeared to be a handle area for the possible cup formation from points E to F to G. If you bought at point I on the breakout attempt, the stock failed again. Reason: the handle was too loose; it declined 20%. However, after failing that time,

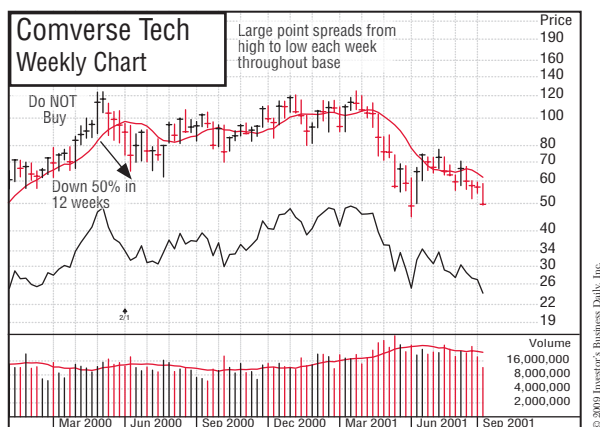


the stock at last tightened up its price structure from points I to J to K, and 15 weeks later, at point K, it broke out of a tight, sound base and nearly tripled in price afterwards. Note the stock's strong uptrend and materially improved relative strength line for 11 months from point K back to point F.

So, there really is a right time and a wrong time to buy a stock, but understanding the difference requires some study. There's no such thing as being an overnight success in the stock market, and success has nothing to do with listening to tips from other people or being lucky. You have to study and prepare yourself so that you can become successful on your own with your investing. So make yourself more knowledgeable. It isn't easy at first, but it can be very rewarding. Anyone can learn to do it. You can do it. Believe in your ability to learn. Unlearn past assumptions that didn't work.

Here are some faulty wide-and-loose patterns that faked people into buying during the prolonged bear market that began in March 2000: Veritas





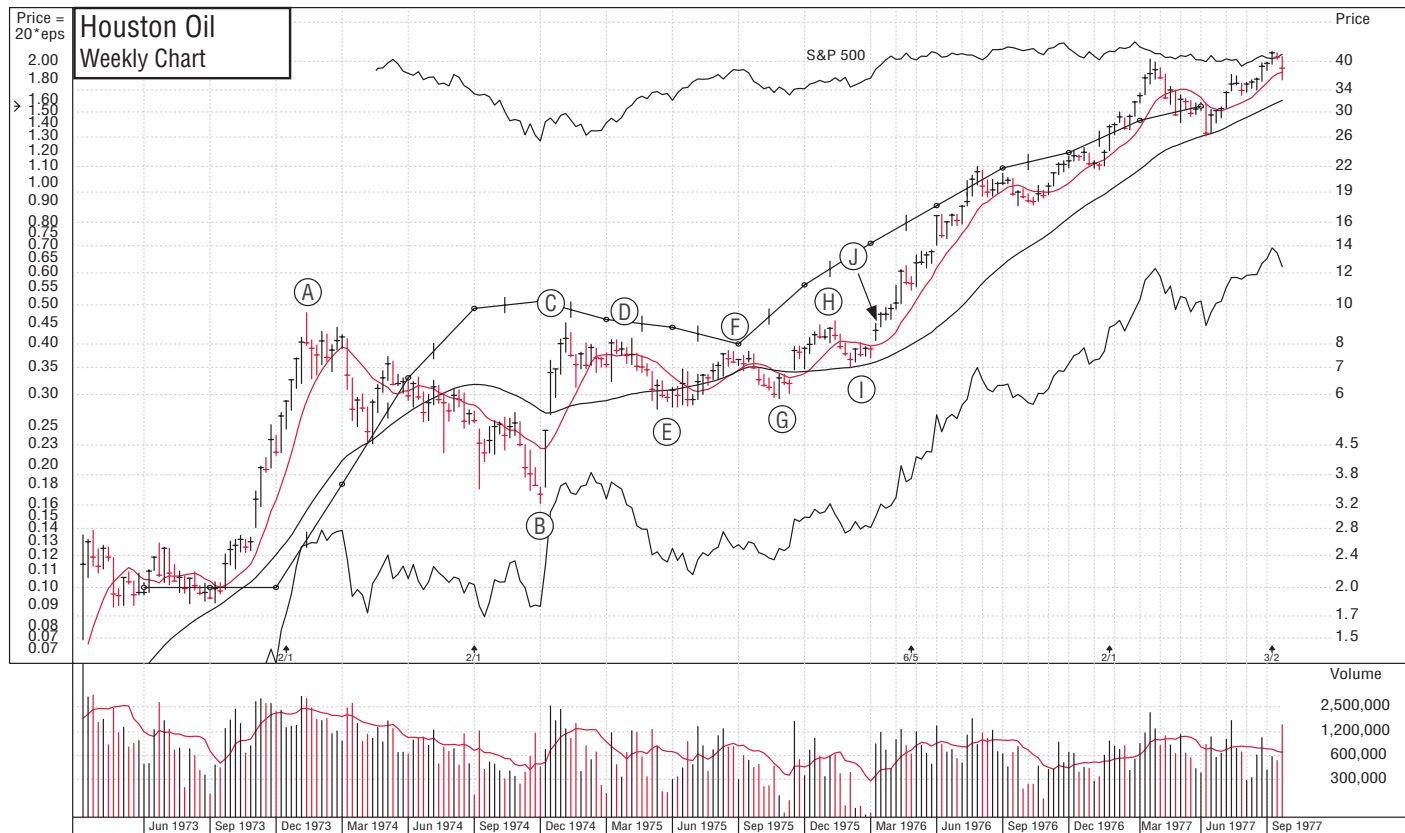
Software on October 20, 2000; Anaren Microwave on December 28, 2000; and Comverse Technology on January 24, 2001.

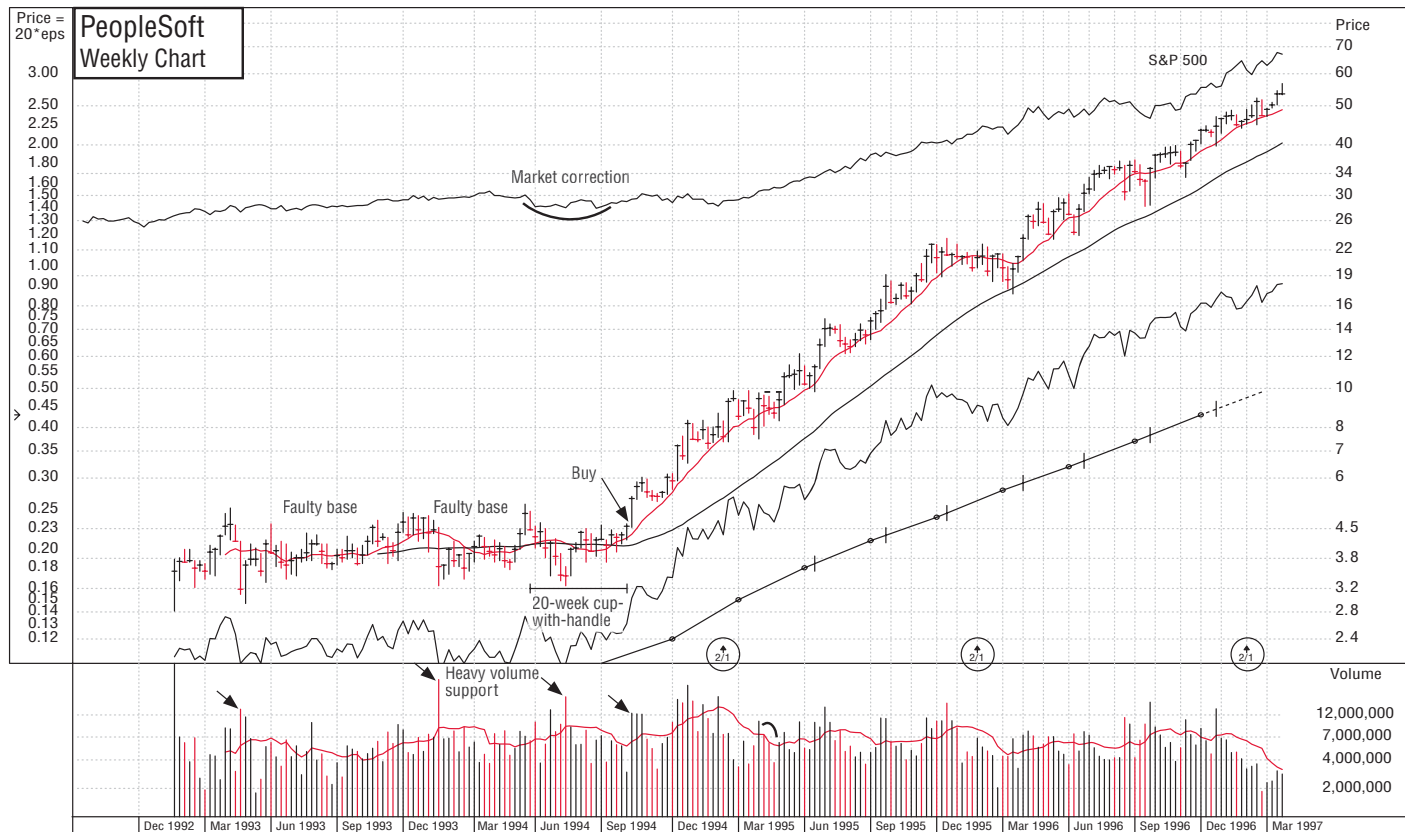
The aforementioned Houston Oil & Minerals is an even more dramatic example of the handle correction from point F to point G being a wide-and-loose pattern that later tightened up into a constructive price formation (see the accompanying chart). A to B to C was extremely wide, loose, and erratic (the percent decline was too great). B to C was straight up from the bottom without any pullback in price. Points C and D were false attempts to break out of a faulty price pattern, and so was point H, which tried to break out of a wide-and-loose cup with handle. Afterward, a tight nine-week base formed from points H to I to J. (Note the extreme volume dry-up along the December 1975 lows.)

An alert stockbroker in Hartford, Connecticut, called this structure to my attention. However, I'd been so conditioned by the two prior years of poor price patterns and less-than-desirable earnings that my mind was slow to change when the stock suddenly altered its behavior in only nine weeks. I was probably also intimidated by the tremendous price increase that had occurred in Houston Oil in the earlier 1973 bull market. This proves that opinions and feelings are frequently wrong, but markets rarely are.

It also points out a very important principle: it takes time for all of us to change opinions that we have built up over a substantial period. In this instance, even the current quarterly earnings turning up 357% after three down quarters didn't change my incorrect bearish view of the stock to a bullish one. The right buy point was in January 1976.

In August 1994, PeopleSoft repeated the New England Nuclear and Houston Oil patterns. It failed in its breakout attempt from a wide, loose, wedging-upward pattern in September 1993. It then failed a second time in its breakout attempt in March 1994, when its handle area formed in the lower





half of its cup-with-handle pattern. Finally, when the chart pattern and the general market were right, PeopleSoft skyrocketed starting in August 1994.

In the first week of January 1999, San Diego-based Qualcomm followed PeopleSoft's three-phased precedent. In October 1997, Qualcomm charged into new-high ground straight up from a loose, faulty base with too much of its base in its lower half. It then built a second faulty base, broke out of a handle in the lower part, and failed. The third base was the charm: a properly formed cup with handle that worked in the first week in January 1999. Qualcomm went straight through the roof from a split-adjusted \$7.50 to \$200 in only one year. Maybe you should spend more time studying historical precedents. What do you think? If you had invested \$7,500 in Qualcomm, a year later it would have been worth \$200,000.

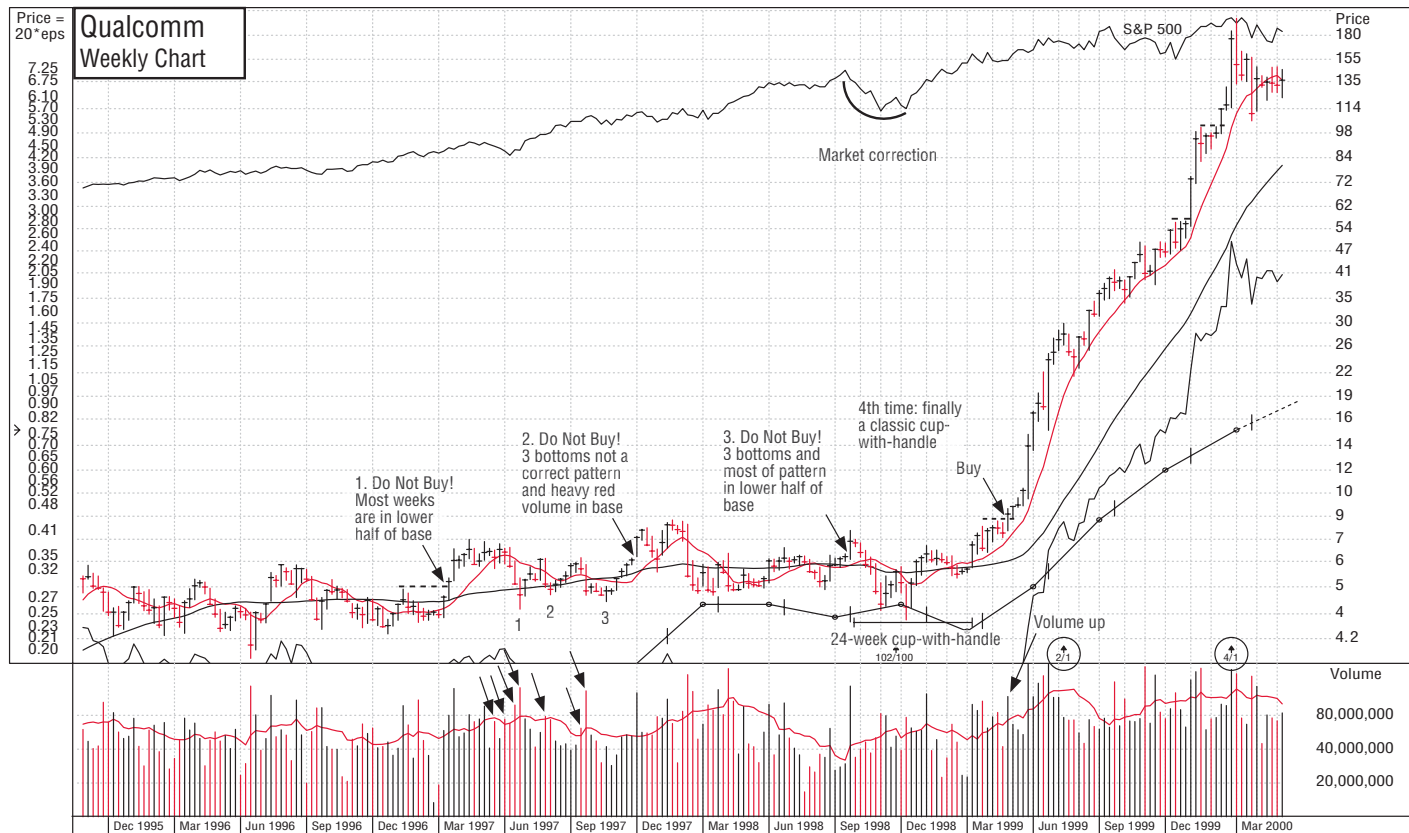
Detecting Faulty Price Patterns and Base Structures

Unfortunately, no original or thorough research on price pattern analysis has been done in the last 78 years. In 1930, Richard Schabacker, a financial editor of *Forbes*, wrote a book, *Stock Market Theory and Practice*. In it he discussed many patterns, including triangles, coils, and pennants. Our detailed model building and investigations of price structure over the years have shown these patterns to be unreliable and risky. They probably worked in the latter part of the "Roaring '20s," when most stocks ran up in a wild, climactic frenzy. Something similar happened in 1999 and the first quarter of 2000, when many loose, faulty patterns at first seemed to work, but then failed. These periods were just like the Dutch tulip bulb craze of the seventeenth century, during which rampant speculation caused varieties of tulip bulbs to skyrocket to astronomical prices and then crash.

Our studies show that, with the exception of high, tight flags, which are extremely rare and hard to interpret, flat bases of five or six weeks, and the square box of four to seven weeks, the most reliable base patterns must have a minimum of seven to eight weeks of price consolidation. Most coils, triangles, and pennants are simply weak foundations without sufficient time or price correction to become proper bases. One-, two-, and three-week bases are risky. In almost all cases, they should be avoided.

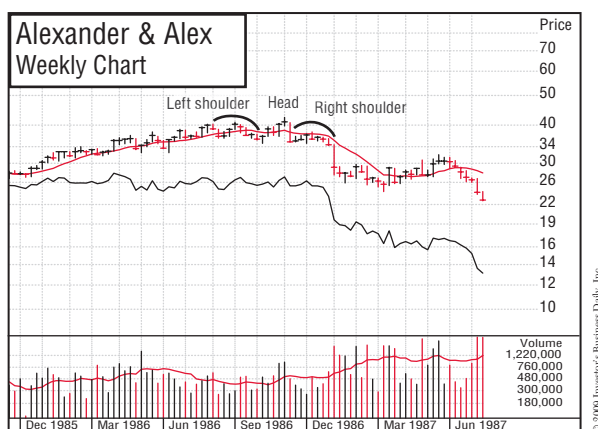
In 1948, John McGee and Robert D. Edwards wrote *Technical Analysis of Stock Trends*, a book that discusses many of the same faulty patterns presented in Schabacker's earlier work.

In 1962, William Jiler wrote an easy-to-read book, *How Charts Can Help You in the Stock Market*, that explains many of the correct principles behind technical analysis. However, it too seems to have continued the display and discussion of certain failure-prone patterns of the pre-Depression era.



Triple bottoms and head-and-shoulders bottoms are patterns that are widely mentioned in several books on technical analysis. We have found these to be weaker patterns as well. A head-and-shoulders bottom may succeed in a few instances, but it has no strong prior uptrend, which is essential for most powerful market leaders.

When it comes to signifying a top in a stock, however, head-and-shoulders top patterns are among the most reliable. Be careful: if you have only a little knowledge of charts, you can misinterpret what is a correct head-and-shoulders top. Many pros don't interpret the pattern properly. The right (second) shoulder must be slightly below the left shoulder (see the chart for Alexander & Alexander).

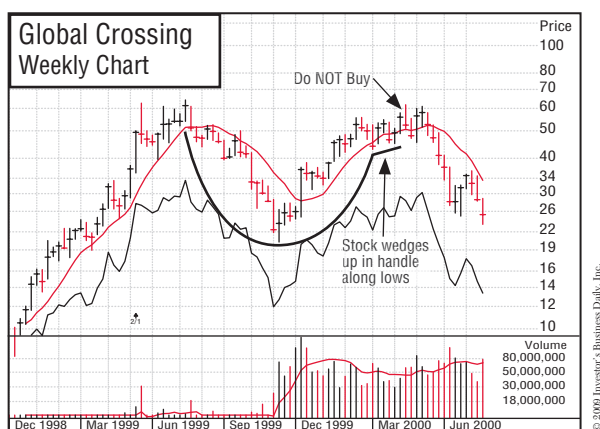


A triple bottom is a looser, weaker, and less-attractive base pattern than a double bottom. The reason is that the stock corrects and falls back sharply to its absolute low three times rather than twice, as with a double bottom, or once, as in the strong cup with handle. As mentioned earlier, a cup with a wedging handle is also usually a faulty, failure-prone pattern, as you can see in the Global Crossing Ltd. chart example. A competent chart reader would have avoided or sold Global Crossing, which later went bankrupt.

How to Use Relative Price Strength Correctly

Many fundamental securities analysts think that technical analysis means buying those stocks with the strongest relative price strength. Others think that technical research refers only to the buying of "high-momentum" stocks. Both views are incorrect.

It's not enough to just buy stocks that show the highest relative price strength on some list of best performers. You should buy stocks that are per-



forming better than the general market just as they are beginning to emerge from sound base-building periods. The time to sell is when the stock has advanced rapidly, is extended materially from its base, and is showing extremely high relative price strength. To recognize the difference, you have to use daily or weekly charts.

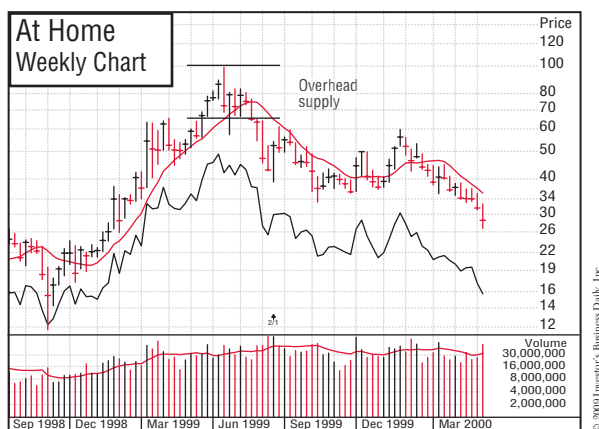
What Is Overhead Supply?

A critically important concept to learn in analyzing price movements is the principle of overhead supply. Overhead supply is when there are significant areas of price resistance in a stock as it moves up after experiencing a downtrend.

These areas of resistance represent prior purchases of a stock and serve to limit and frustrate its upward movement because the investors who made these purchases are motivated to sell when the price returns to their entry point. (See the chart for At Home.) For example, if a stock advances from \$25 to \$40, then declines back to \$30, most of the people who bought it in the upper \$30s and at \$40 will have a loss in the stock unless they were quick to sell and cut their loss (which most people don't do). If the stock later climbs back to the high \$30s or \$40 area, the investors who had losses can now get out and break even.

These are the holders who promised themselves: "If I can just get out even, I will sell." Human nature doesn't change. So it's normal for a number of these people to sell when they see a chance to get their money back after having been down a large amount.

Good chartists know how to recognize the price zones that represent heavy areas of overhead supply. They will never make the fatal mistake of



buying a stock that has a large amount of recent overhead supply. This is a serious mistake that many analysts who are concerned solely with fundamentals sometimes make.

A stock that's able to fight its way through its overhead supply, however, may be safer to buy, even though the price is a little higher. It has proved to have sufficient demand to absorb the supply and move past its level of resistance. Supply areas more than two years old create less resistance. Of course, a stock that has just broken out into new high ground for the first time has no overhead supply to contend with, which adds to its appeal.

Excellent Opportunities in Unfamiliar, Newer Stocks

Alert investors should have a way of keeping track of all new stock issues that have emerged over the last 10 to 15 years. This is important because some of these newer and younger companies will be among the most stunning performers of the next year or two. Most of these issues trade on the Nasdaq market.

Some new issues move up a small amount and then retreat to new price lows during a bear market, making a poor initial impression. But when the next bull market begins, a few of these forgotten newcomers will sneak back up unnoticed, form base patterns, and suddenly take off and double or triple in price if they have earnings and sales that are good and improving.

Most investors miss these outstanding price moves because they occur in new names that are largely unknown to most people. A charting service can help you spot these unfamiliar, newer companies, but make sure that your service follows a large number of stocks (not just one or two thousand).

Successful, young growth stocks tend to enjoy their fastest earnings growth between their fifth and tenth years in business, so keep an eye on them during their early growth periods.

To summarize, dramatically improve your stock selection and overall portfolio performance by learning to read and use charts. They provide a gold mine of information. It will take some time and study on your part to become good at this, but it's an invaluable skill you can learn. You may have to re-read this chapter several times in the first year or two if you really want to be good at chart reading. The big secret is for you to combine skillful chart reading with stocks that have outstanding earnings and sales growth, plus superior returns on equity or pre-tax profit margins. You need both fundamentals and chart reading, not just one or the other.

● **A Loud Warning to the Wise about Bear Markets!!!**

Let me offer one last bit of judicious guidance. If you are new to the stock market or the historically tested and proven strategies outlined in this book, or, more importantly, if you are reading this book for the first time near the beginning or middle of a bear market, do not expect the presumed buy patterns to work. Most of them will definitely be defective. *You absolutely do not buy breakouts during a bear market.* Most of them will fail.

The price patterns will be too deep, wide, and loose in appearance compared to earlier patterns. They will be third- and fourth-stage bases; have wedging or loose, sloppy handles; have handles in the lower half of the base; or show narrow "V" formations moving straight up from the bottom of a base into new highs, without any handle forming. Some patterns may show laggard stocks with declining relative strength lines and price patterns with too much adverse volume activity or every week's price spread wide.

It isn't that bases, breakouts, or the method isn't working anymore; it's that the timing and the stocks are simply all wrong. The price and volume patterns are phony, faulty, and unsound. The general market is turning negative. It is selling time. Be patient, keep studying, and be 100% prepared. Later, at the least expected time, when all the news is terrible, winter will ultimately pass and a great new bull market will suddenly spring to life. The practical techniques and proven disciplines discussed here should work for you for many, many future economic cycles. So get prepared and do your homework. Create your own buy and sell rules that you will constantly use.

C = Current Big or Accelerating Quarterly Earnings and Sales per Share

Dell Computer, Cisco Systems, America Online—why, among the thousands of stocks that trade each day, did these three perform so well during the 1990s, posting gains of 1,780%, 1,467%, and 557%, respectively?

Or for that matter, what about Google, which started trading at \$85 a share in August 2004 and didn't stop climbing until it peaked at over \$700 in 2007? Or Apple, which had emerged from a perfect cup-with-handle pattern six months earlier at a split-adjusted \$12 a share and reached \$202 in 45 months?

What key traits, among the hundreds that can move stocks up and down, did these companies all have in common?

These are not idle questions. The answers unlock the secret to true success in the stock market. Our study of all the stock market superstars from the last century and a quarter found that they did indeed share common characteristics.

None of these characteristics, however, stood out as boldly as the large percentage earnings per share increase each big winner reported in the latest quarter or two before its major price advance. For example:

- Dell's earnings per share surged 74% and 108% in the two quarters prior to its price increase from November 1996.
- Cisco posted earnings gains of 150% and 155% in the two quarters ending October 1990, prior to its giant run-up over the next three years.
- America Online's earnings were up 900% and 283% before its six-month burst from October 1998.

- Google showed earnings gains of 112% and 123% in the two quarters before it made its spectacular debut as a public company.
- Apple's earnings were up 350% in the quarter before it took off, and its next quarter was up another 300%.

But this isn't just a recent phenomenon. Explosive earnings have accompanied big stock moves throughout the stock market's great history in America. Studebaker's earnings were up 296% before it sped from \$45 to \$190 in eight months in 1914, and Cuban American Sugar's earnings soared 1,175% in 1916, the same year its stock climbed from \$35 to \$230.

In the summer of 1919, Stutz Motor Car was showing an earnings gain of 70% before the prestigious manufacturer of high-performance sports cars—you remember the Bearcat, don't you?—raced from \$75 to \$385 in just 40 weeks.

Earnings at U.S. Cast Iron Pipe rose from \$1.51 a share at the end of 1922 to \$21.92 at the end of 1923, an increase of 1,352%. In late 1923, the stock traded at \$30; by early 1925, it went for \$250.

And in March of 1926, du Pont de Nemours showed earnings up 259% before its stock took off from \$41 that July and got to \$230 before the 1929 break.

In fact, if you look down a list of the market's biggest winners year-in and year-out, you'll instantly see the relationship between booming profits and booming stocks.

And you'll see why our studies have concluded that

The stocks you select should show a major percentage increase in current quarterly earnings per share (the most recently reported quarter) when compared to the prior year's same quarter.

Buy Stocks Showing "Huge Current Earnings Increases"

In our models of the 600 best-performing stocks from 1952 to 2001, three out of four showed earnings increases averaging more than 70% in the latest publicly reported quarter *before* they began their major advances. Those that *did not* show solid current quarterly earnings increases did so in *the very next quarter*, with an average earnings increase of 90%!

Priceline.com was showing earnings up "only" 34% in the June quarter of 2006, when its stock began a move from \$30 to \$140. But its earnings accelerated, rising 53%, 107%, and 126%, in the quarters that followed.

From 1910 to 1950, most of the very best performers showed quarterly earnings gains ranging from 40% to 400% before their big price moves.

So, if the best stocks had profit increases of this magnitude before they advanced rapidly in price, why should you settle for anything less? You may find that only 1% or 2% of stocks listed on Nasdaq or the New York Stock Exchange show earnings gains of this size. But remember: you're looking for stocks that are exceptional, not lackluster. Don't worry; they're out there.

As with any search, however, there can be traps and pitfalls along the way, and you need to know how to avoid them.

The earnings per share (EPS) number you want to focus on is calculated by dividing a company's total after-tax profits by the number of common shares outstanding. This percentage change in EPS is the single most important element in stock selection today. The greater the percentage increase, the better.

And yet during the Internet boom of the wild late 1990s, some people bought stocks based on nothing more than big stories of profits and riches to come, as most Internet and dot-com companies had shown only deficits to date. Given that companies such as AOL and Yahoo! were actually showing earnings, risking your hard-earned money in other, unproven stocks was simply not necessary.

AOL and Yahoo! were the real leaders at that time. When the inevitable market correction (downturn) hit, lower-grade, more speculative companies with no earnings rapidly suffered the largest declines. You don't need that added risk.

I am continually amazed at how some professional money managers, let alone individual investors, buy common stocks when the current reported quarter's earnings are flat (no change) or down. There is absolutely no good reason for a stock to go anywhere in a big, sustainable way if its current earnings are poor.

Even profit gains of 5% to 10% are insufficient to fuel a major price movement in a stock. Besides, a company showing an increase of as little as 8% or 10% is more likely to suddenly report lower or slower earnings the next quarter.

Unlike some institutional investors such as mutual funds, banks, and insurance companies, which have billions under management and which may be restricted by the size of their funds, individual investors have the luxury of investing in only the very best stocks in each bull cycle. While some companies with no earnings (like Amazon.com and Priceline.com) had big moves in their stocks in 1998–1999, most investors in that time period would have been better off buying stocks like America Online and Charles Schwab, both of which had strong earnings.

Following the CAN SLIM strategy's emphasis on earnings ensures that an investor will always be led to the strongest stocks in any market cycle,

regardless of any temporary, highly speculative “bubbles” or euphoria. Of course, you never buy on earnings growth alone. Several other factors, which we’ll cover in the chapters that follow, are also essential. It’s just that EPS percentage increase is the *most* important.

Watch Out for Misleading Earnings Reports

Have you ever read a corporation’s quarterly earnings report that went like this:

We had a terrible first three months. Prospects for our company are turning down because of inefficiencies at the home office. Our competition just came out with a better product, which will adversely affect our sales. Furthermore, we are losing our shirt on the new Midwestern operation, which was a real blunder on management’s part.

No way! Here’s what you see instead:

Greatshakes Corporation reports record sales of \$7.2 million versus \$6 million (+20%) for the quarter ended March 31.

If you’re a Greatshakes stockholder, this sounds like wonderful news. You certainly aren’t going to be disappointed. After all, you believe that this is a fine company (if you didn’t, you wouldn’t have invested in it in the first place), and the report confirms your thinking.

But is this “record-breaking” sales announcement a good report? Let’s suppose the company also had record earnings of \$2.10 per share, up 5% from the \$2.00 per share reported for the same quarter a year ago. Is it even better now? The question you have to ask is, why were sales up 20% but earnings ahead only 5%? What does this say about the company’s profit margins?

Most investors are impressed with what they read, and companies love to put their best foot forward in their press releases and TV appearances. However, even though this company’s sales grew 20% to an all-time high, it didn’t mean much for the company’s profits. The key question for the winning investor must always be:

**How much are the current quarter’s earnings per share up
(in percentage terms) from the same quarter the year before?**

Let’s say your company discloses that sales climbed 10% and net income advanced 12%. Sound good? Not necessarily. You shouldn’t be concerned with the company’s total net income. You don’t own the whole organization; you own shares in it. Over the last 12 months, the company might have issued additional shares or “diluted” the common stock in other ways. So

while net income may be up 12%, earnings per share—your main focus as an investor—may have edged up only 5% or 6%.

You must be able to see through slanted presentations. Don't let the use of words like *sales* and *net income* divert your attention from the truly vital facts like current quarterly earnings. To further clarify this point:

You should always compare a company's earnings per share to the same quarter a year earlier, not to the prior quarter, to avoid any distortion resulting from seasonality. In other words, you don't compare the December quarter's earnings per share to the prior September quarter's earnings per share. Rather, compare the December quarter to the December quarter of the previous year for a more accurate evaluation.

Omit a Company's One-Time Extraordinary Gains

The winning investor should avoid the trap of being influenced by nonrecurring profits. For example, if a computer maker reports earnings for the last quarter that include nonrecurring profits from activities such as the sale of real estate, this portion of earnings should be subtracted from the report. Such earnings represent a one-time event, not the true, ongoing profitability of corporate operations. Ignore the earnings that result from such events.

Is it possible that the earnings of New York's Citigroup bank may have been propped up at times during the 1990s by nonrecurring sales of commercial real estate prior to the bank's later leveraged involvement in the subprime disaster?

Set a Minimum Level for Current Earnings Increases

Whether you're a new or an experienced investor, I would advise against buying any stock that doesn't show earnings per share up at least 18% or 20% in the most recent quarter versus the same quarter the year before. In our study of the greatest winning companies, we found that they all had this in common *prior* to their big price moves. Many successful investors use 25% or 30% as their minimum earnings parameter.

To be even safer, insist that both of the last two quarters show significant earnings gains. During bull markets (major market uptrends), I prefer to concentrate on stocks that show powerful earnings gains of 40% to 500% or more. You have thousands of stocks to choose from. Why not buy the very best merchandise available?

To further sharpen your stock selection process, look ahead to the next quarter or two and check the earnings that were reported for those same

quarters the previous year. See if the company will be coming up against unusually large or small earnings achieved a year ago. When the unusual year-earlier results are not caused by seasonal factors, this step may help you anticipate a strong or poor earnings report in the coming months.

Also, be sure to check consensus earnings estimates (projections that combine the earnings estimates of a large group of analysts) for the next several quarters—and for the next year or two—to make sure the company is projected to be on a positive track. Some earnings estimate services even show an estimated annual earnings growth rate for the next five years for many companies.

Many individuals and even some institutional investors buy stocks whose earnings were down in the most recently reported quarter because they like the company and think that its stock price is “cheap.” Usually they accept the story that earnings will rebound strongly in the near future. In some cases this may be true, but in many cases it isn’t. Again, the point is that you have the choice of investing in thousands of companies, many of which are actually showing strong operating results. You don’t have to accept promises of earnings that may never occur.

Requiring that current quarterly earnings be up a hefty amount is just another smart way for the intelligent investor to reduce the risk of mistakes in stock selection. But you must also understand in the late stage of a bull market, some or even many leaders that have had long runs can top out even though their current earnings are up 100%. This usually fools investors and analysts alike. It pays to know your market history.

Avoid Big Older Companies with Maintainer Management

In fact, many older American corporations have mediocre management that continually produces second-rate earnings results. I call these people the “entrenched maintainers” or “caretaker management.” You want to avoid these companies until someone has the courage to change the top executives. Not coincidentally, they are generally the companies that strain to pump up their current earnings a still-dull 8% or 10%. True growth companies with outstanding new products or improved management do not have to inflate their current results.

Look for Accelerating Quarterly Earnings Growth

Our analysis of the most successful stocks also showed that, in almost every case, earnings growth *accelerated* sometime in the 10 quarters before a towering price move began. In other words, it’s not just increased earnings and

the size of the increase that cause a big move. It's also that the increase represents an improvement from the company's prior rate of earnings growth. If a company's earnings have been up 15% a year and suddenly begin spurt-ing 40% to 50% or more—what Wall Street usually calls “earnings surprises”—this usually creates the conditions for important stock price improvement.

Other valuable ways to track a stock's earnings include determining how many times in recent months analysts have raised their estimates for the company plus the percentage by which several previous quarterly earnings reports have actually beaten their consensus estimates.

Insist on Sales Growth as Well as Earnings Growth

Strong and improving quarterly earnings should always be supported by sales growth of at least 25% for the latest quarter, or at least an acceleration in the rate of sales percentage improvement over the last three quarters. Certain superior newer issues (initial public offerings) may show sales growth averaging 100% or more in each of the prior 8, 10, or 12 quarters. Check all these stocks out.

Take particular note if the growth of *both* sales and earnings has accelerated for the last three quarters. You don't want to get impatient and sell your stock if it shows this type of acceleration. Stick to your position.

Some professional investors bought Waste Management at \$50 in early 1998 because earnings had jumped three quarters in a row from 24% to 75% and 268%. But sales were up only 5%. Several months later, the stock collapsed to \$15 a share.

This demonstrates that companies can inflate earnings for a few quarters by reducing costs or spending less on advertising, research and development, and other constructive activities. To be sustainable, however, earnings growth must be supported by higher sales. Such was not the case with Waste Management.

It will also improve your batting average if the latest quarter's after-tax profit margins for your stock selections are at or near a new high and among the very best in the company's industry. Yes, you have to do a little homework if you want to really improve your results. No pain, no gain.

Two Quarters of Major Earnings Deceleration Can Be Trouble for Your Stock

Just as it's important to recognize when quarterly earnings growth is accelerating, it's also important to know when earnings begin to *decelerate*, or

slow down significantly. If a company that has been growing at a quarterly rate of 50% suddenly reports earnings gains of only 15%, that might spell trouble, and you may want to avoid that company.

Even the best organizations can have a slow quarter every once in a while. So before turning negative on a company's earnings, I prefer to see two consecutive quarters of *material* slowdown. This usually means a decline of two-thirds or greater from the previous rate—a slowdown from 100% earnings growth to 30%, for example, or from 50% to 15%.

Consult Log-Scale Weekly Graphs

Understanding the principle of earnings acceleration or deceleration is essential.

Securities analysts who recommend stocks because of the absolute level of earnings expected for the following year could be looking at the wrong set of numbers. The fact that a stock earned \$5 per share and expects to report \$6 the next year (a “favorable” 20% increase) could be misleading unless you know the previous trend in the percentage rate of earnings change. What if earnings were previously up 60%? This partially explains why so few investors make significant money following the buy and sell recommendations of securities analysts.

Logarithmic-scale graphs are of great value in analyzing stocks because they can clearly show acceleration or deceleration in the percentage rate of quarterly earnings increases. One inch anywhere on the price or earnings scale represents the same percentage change. This is not true of arithmetically scaled charts.

On arithmetically scaled charts, a 100% price move from \$10 to \$20 shows the same space change as a 50% increase from \$20 to \$30. But a log-scale graph shows a 100% increase as twice as large as the 50% increase. Weekly charts in Daily Graphs Online are properly logarithmic.

As a do-it-yourself investor, you can take the latest quarterly earnings per share along with the prior three quarters' EPS, and plot them on a logarithmic-scale graph to get a clear picture of earnings acceleration or deceleration. For the best companies, plotting the most recent 12-month earnings each quarter should put the earnings per share point close to or already at new highs.

Check Other Stocks in the Group

For additional validation, check the earnings of other companies in your stock's industry group. If you can't find at least one other impressive stock

displaying strong earnings in the group, chances are you may have selected the wrong investment.

Where to Find Current Quarterly Earnings Reports

Quarterly corporate earnings statements used to be published in the business sections of most local newspapers and financial publications every day. But most newspapers have downsized their business sections these days, dropping data right and left. As a result, they no longer adequately cover the critical facts investors need to know.

This is not true of *Investor's Business Daily*. IBD not only continues to provide detailed earnings coverage, but goes a step further and separates all new earnings reports into companies with “up” earnings and those reporting “down” results, so you can easily see who produced excellent gains and who didn't.

Chart services such as Daily Graphs® and Daily Graphs Online also show earnings reported during the week as well as the most recent earnings figures for every stock they chart. Once you locate the percentage change in earnings per share when compared to the same year-ago quarter, also compare the percentage change in EPS on a quarter-by-quarter basis. Looking at the March quarter and then at the June, September, and December quarters will tell you if a company's earnings growth is accelerating or decelerating.

You now have the first crucial rule for improving your stock selection:

Current quarterly earnings per share should be up a major percentage—25% to 50% at a minimum—over the same quarter the previous year. The best companies can show earnings up 100% to 500% or more!

A mediocre 10% or 12% isn't enough. When you're picking winning stocks, it's the bottom line that counts.

A = Annual Earnings Increases: Look for Big Growth

Any company can report a good earnings quarter every once in a while. And as we've seen, strong current quarterly earnings are critical to picking most of the market's biggest winners. But they're not enough.

To make sure the latest results aren't just a flash in the pan, and the company you're looking at is of high quality, you must insist on more proof. The way to do that is by reviewing the company's *annual* earnings growth rate.

Look for annual earnings per share that have increased in each of the last three years. You normally don't want the second year's earnings to be down, even if the results in the following year rebound to the highest level yet. It's the combination of strong earnings in the last several quarters plus a record of solid growth in recent years that creates a superb stock, or at least one with a higher probability of success during an uptrending general market.

Select Stocks with 25% to 50% and Higher Annual Earnings Growth Rates

The annual rate of earnings growth for the companies you pick should be 25%, 50%, or even 100% or more. Between 1980 and 2000, the median annual growth rate of all outstanding stocks in our study at their early emerging stage was 36%. Three out of four big winners showed at least some positive annual growth over the three years, and in some cases the five years, preceding the stocks' big run-ups.

A typical earnings-per-share progression for the five years preceding the stock's move might be something like \$0.70, \$1.15, \$1.85, \$2.65, and \$4.00.

In a few cases, you might accept one down year in five as long as the following year's earnings move back to new high ground.

It's possible a company could earn \$4.00 a share one year, \$5.00 the next, \$6.00 the next, and then \$3.00 a share. If the next annual earnings statement was, say, \$4.00 per share versus the prior year's \$3.00, this would not be a good report despite the 33% increase over the prior year. The only reason it might seem positive is that the previous year's earnings (\$3.00 a share) were so depressed that any improvement would look good. The point is, profits are recovering slowly and are still well below the company's peak annual earnings of \$6.00 a share.

The consensus among analysts on what earnings will be for the next year should also be up—the more, the better. But remember: estimates are personal opinions, and opinions may be wrong (too high or too low). Actual reported earnings are facts.

Look for a Big Return on Equity

You should also be aware of two other measurements of profitability and growth: return on equity and cash flow per share.

Return on equity, or ROE, is calculated by dividing net income by shareholders' equity. This shows how efficiently a company uses its money, thereby helping to separate well-managed firms from those that are poorly managed. Our studies show that nearly all the greatest growth stocks of the past 50 years had ROEs of at least 17%. (The really superior growth situations will sport 25% to 50% ROEs.)

To determine cash flow, add back the amount of depreciation the company shows to reflect the amount of cash that is being generated internally. Some growth stocks can also show annual cash flow per share that is at least 20% greater than actual earnings per share.

Check the Stability of a Company's Three-Year Earnings Record

Through our research, we've determined another factor that has proved important in selecting growth stocks: the stability and consistency of annual earnings growth over the past three years. Our stability measurement, which is expressed on a scale of 1 to 99, is calculated differently from most statistics. The lower the figure, the more stable the past earnings record. The figures are calculated by plotting quarterly earnings for the past three or five years and fitting a trend line around the plotted points to determine the degree of deviation from the basic growth trend.

Growth stocks with steady earnings tend to have a stability figure below 20 or 25. Companies with stability ratings over 30 are more cyclical and a little less dependable in terms of their growth. All other things being equal, you may want to look for stocks showing a greater degree of sustainability, consistency, and stability in past earnings growth. Some companies that are growing 25% per year could have a stability rating of 1, 2, or 3. When the quarterly earnings for several years are plotted on a log-scale chart, the earnings line should be nearly straight, consistently moving up. In most cases there will be some acceleration in the rate of increase in recent quarters.

Ctrip.com	Nov. 13, 2009
EPS Growth Rate	46%
Earnings Stability	8
P/E Ratio	47 (2.0 x SP)
5-Year P/E Range	13–66
Return on Equity	35%
Cash Flow	\$1.34

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Sample earnings stability

Earnings stability numbers are customarily shown right after a company's annual growth rate, but most analysts and investment services don't bother to make the calculation. We show them in many of our institutional products as well as in Daily Graphs and Daily Graphs Online, which are designed for individual investors.

If you restrict your stock selections to ventures with proven growth records, you will avoid the hundreds of investments with erratic histories or cyclical recoveries in profits. A few such stocks could "top out" as they approach the peaks of their prior earnings cycle.

What Is a Normal Stock Market Cycle?

History demonstrates most bull (up) markets last two to four years and are followed by a recession or a bear (down) market. Then another bull market starts.

In the beginning phase of a new bull market, growth stocks are usually the first to lead and make new price highs. These are companies whose profits have grown quarter to quarter, but whose stocks have been held back by the poor general market conditions. The combination of a general market decline and a stock's continued profit growth will have compressed the price/earnings (P/E) ratio to a point where it is attractive to institutional investors, for whom P/Es are important.

Cyclical stocks in basic industries such as steel, chemicals, paper, rubber, autos, and machinery usually lag in the new bull market's early phase.

Young growth stocks will typically dominate for at least two bull market cycles. Then the emphasis may change to cyclicals, turnarounds, or other newly improved sectors for a short period.

While three out of four big market winners in the past were growth stocks, one in four was a cyclical or turnaround situation. In 1982, Chrysler and Ford were two such spirited turnaround plays. Cyclical and turnaround opportunities led in the market waves of 1953–1955, 1963–1965, and 1974–1975. Cyclicals including paper, aluminum, autos, chemicals, and plastics returned to the fore in 1987, and home-building stocks, which are also cyclical, have led in other periods. Examples of turnaround situations include IBM in 1994 and Apple in 2003.

Yet even when cyclical stocks are in favor, some pretty dramatic young growth issues are also available. Cyclical stocks in the United States are often those in older, less-efficient industries. Some of these companies weren't competitive until the demand for steel, copper, chemicals, and oil surged as a result of the rapid buildup of basic industries in China. That's why cyclicals were resurrected aggressively after the 2000 bear market ended in 2003.

They are still cyclical stocks, however, and they may not represent America's true future. In addition, large, old-line companies in America frequently have the added disadvantage of size: they are simply too large to be able to innovate and continually renew themselves so that they can compete with nimble foreign rivals and with America's young new entrepreneurs.

Rallies in cyclical stocks may tend to be more short-lived and prone to falter at the first hint of a recession or an earnings slowdown. Should you decide to buy a turnaround stock, look for annual earnings growth of at least 5% to 10% and two straight quarters of sharp earnings recovery that lift results for the latest 12 months into or very near new high ground. Check the 12-month earnings line on a stock chart; the sharper the angle of the earnings upswing, the better.

If the profit upswing is so dramatic that it reaches a new high, one quarter of earnings turnaround will sometimes suffice. Cleveland Cliffs, a supplier of iron ore pellets to the steel industry (and now known as Cliffs Natural Resources), came from a deficit position to dramatically accelerate quarterly earnings in 2004 by 64% and then by 241%. With that impetus, the stock rapidly advanced 170% in the next eight months.

How to Weed Out the Losers in a Group

Insisting on three years of earnings growth will help you quickly weed out 80% of the stocks in any industry group. Growth rates for most stocks in most groups are lackluster or nonexistent—unlike, for example,

- Xerox, which was growing at a 32% annual rate before its shares soared 700% from March 1963 to June 1966
- Wal-Mart Stores, which consistently created an annual growth rate of 43% before rocketing 11,200% from 1977 to 1990
- Cisco Systems, whose earnings were exploding at a 257% rate in October 1990, and Microsoft, which was growing at a 99% clip in October 1986, before their enormous advances
- Priceline.com, which from 2004 to 2006 more than doubled its earnings from 96 cents a share to \$2.03, before it tripled in price in the next five quarters
- Google, which had already expanded its earnings from 55 cents a share in 2002 to \$2.51 a share in 2004 before its stock climbed from \$200 to \$700 by 2007

Keep in mind that an annual growth record doesn't necessarily make a company a solid growth stock. In fact, some so-called growth stocks report substantially slower growth than they did in earlier market periods. Many growth leaders in one cycle do not repeat in the next cycle.

The stock of a company that has an outstanding three-year growth record of 30% but whose earnings growth has slowed to 10% or 15% in the last several quarters acts like a fully mature growth stock. Older and larger organizations are usually characterized by slower growth, and many of them should be avoided. America is continually led and driven by new innovative entrepreneurial companies. They, and not our government, create our new industries.

Insist on Both Annual and Current Quarterly Earnings Being Excellent

A standout stock needs both a sound growth record in recent years and a strong current earnings record in the last several quarters. It's the powerful combination of these two critical factors, rather than one or the other, that creates a super stock, or at least one that has a higher chance for true success.

The fastest way to find a company with strong and accelerating current earnings and solid three-year growth is by checking the proprietary Earnings per Share (EPS) Rating provided for every stock listed in *Investor's Business Daily's* research stock tables.

The EPS Rating measures a company's two most recent quarters of earnings growth against the same quarters the year before and examines its growth rate over the last three years. The results are then compared with those of all other publicly traded companies and rated on a scale from 1 to 99, with 99 being best. An EPS Rating of 99 means a company

has outperformed 99% of all other companies in terms of both annual and recent quarterly earnings performance.

If the stock is newly issued and the company doesn't have a three-year earnings record, look for big earnings increases and even bigger sales growth over the last five or six quarters. One or two quarters of profitability are often not enough and indicate a less-proven stock that might fall apart somewhere down the line.

Are Price/Earnings Ratios Really Important?

If you're like most investors, you've probably learned the most important thing you need to know about a stock is its P/E ratio. Well, prepare yourself for a bubble-bursting surprise.

For years, analysts have used P/E ratios as their basic measurement tool in deciding whether a stock is undervalued (has a low P/E) and should be bought, or is overvalued (has a high P/E) and should be sold. But our ongoing analysis of the most successful stocks from 1880 to the present shows that, contrary to most investors' beliefs, P/E ratios were not a relevant factor in price movement and have very little to do with whether a stock should be bought or sold.

Much more crucial, we found, was the percentage increase in earnings per share. To say that a security is "undervalued" because it's selling at a low P/E or because it's in the low end of its historical P/E range can be nonsense.

Primary consideration should be given to whether the rate of change in earnings is substantially increasing or decreasing.

From 1953 through 1985, the average P/E ratio for the best-performing stocks at their early emerging stage was 20. (The average P/E of the Dow Jones Industrials over the same period was 15.) As they advanced, the biggest winners expanded their P/Es by 125%, to about 45. From 1990 to 1995, the real leaders began with an average P/E of 36 and expanded into the 80s. But these were just the averages. Beginning P/Es for most big winners ranged from 25 to 50, and the P/E expansions varied from 60 to 115. In the market euphoria of the late 1990s, these valuations increased to even greater levels. Value buyers missed almost all of these tremendous investments.

Why You Missed Some Fabulous Stocks!

These findings strongly suggest that if you weren't willing to buy growth stocks at 25 to 50 times earnings, or even much more, you automatically eliminated most of the best investments available! You missed Microsoft, Cisco Systems, Home Depot, America Online, and many, many others during their periods of greatest market performance.

Our studies suggest P/E ratios are an end effect of accelerating earnings that, in turn, attract big institutional buyers, resulting in strong price performance. P/Es are not a cause of excellent performance. High P/Es, for example, were found to occur because of bull markets. Low P/Es, with the exception of those on cyclical stocks, generally occurred because of bear markets.

In a roaring bull market, don't overlook a stock just because its P/E seems too high. It could be the next great winner. And never buy a stock just because the P/E ratio makes it look like a bargain. There are usually good reasons why the P/E is low, and there's no golden rule that prevents a stock that sells at 8 or 10 times earnings from going even lower and selling at 4 or 5 times earnings.

Many years ago, when I first began to study the market, I bought Northrop at 4 times earnings and watched in disbelief as the stock declined to a P/E ratio of 2.

How Price/Earnings Ratios Are Misused

Many Wall Street analysts put a stock on their "buy" list because it's selling at the low end of its historical P/E range. They'll also recommend a stock when the price starts to drop, thereby lowering the P/E and making it seem like an even bigger bargain.

In 1998, Gillette and Coca-Cola looked like great buys because they had sold off several points and their P/Es looked more attractive. In actuality, the earnings at both companies were showing a material deceleration that justified a lower valuation. A great deal of P/E analysis is based on personal opinions and theories that have been handed down through the years by analysts, academicians, and others, whose track records when it comes to making money in the market are both questionable and undocumented. In 2008, some Wall Street analysts recommended buying Bank of America all the way down. There are no safe, sure things in the market. That's why you need avoid or sell rules as well as buy rules.

Reliance on P/E ratios often ignores more basic trends. The general market, for example, may have topped, in which case all stocks are headed lower. To say a company is undervalued because at one time it was selling at 22 times earnings and it can now be bought for 15 is ridiculous and somewhat naive.

One way I *do* sometimes use P/E ratios is to estimate the potential price objective for a growth stock over the next 6 to 18 months based on its estimated future earnings. I may take the earnings estimate for the next two years and multiply it by the stock's P/E ratio at the initial chart base buy

point, then multiply the result by 100% or slightly more. This is the degree of P/E expansion possible on average if a growth stock has a major price move. This tells me what a growth stock could potentially sell for during bull market conditions. However, there are some bull markets and certain growth stocks that may have little or no P/E expansion.

For example, if Charles Schwab's stock breaks out of its first base at \$43.75 per share (as it did in late 1998) and its P/E ratio at the beginning buy point is 40, multiply 40 by 130% to see that the P/E ratio could possibly expand to 92 if the stock has a huge price move. Next, multiply the potential P/E ratio of 92 by the consensus earnings estimate two years out of \$1.45 per share. This tells you what a possible price objective for your growth stock might be.

The Wrong Way to Analyze Companies in an Industry

Another faulty use of P/E ratios, by amateurs and professionals alike, is to evaluate the stocks in an industry and conclude the one selling at the cheapest P/E is always undervalued and therefore the most attractive purchase. The reality is, the lowest P/E usually belongs to the company with the most ghastly earnings record.

The simple truth is that at any given time, stocks usually sell near their current value. The stock that sells at 20 times earnings is at that level for one set of reasons, and the stock that trades at 15 times earnings is at that level for another set of reasons. A stock selling at, say, 7 times earnings does so because its overall record is more deficient than that of a stock with a higher P/E ratio. Also, keep in mind that cyclical stocks normally have lower P/Es, and that, even in good periods, they do not show the P/E expansion that occurs in growth stocks.

You can't buy a Mercedes for the price of a Chevrolet, and you can't buy oceanfront property for the same price you'd pay for land a couple of miles inland. Everything sells for about what it's worth at the time based on the law of supply and demand.

The increased value of great paintings was brought about almost single-handedly many years ago by a fine-arts dealer named Joseph Duveen. He would travel to Europe and buy one-of-a-kind paintings by Rembrandt and others, paying more than the market price. He would then bring them back to the United States and sell them to Henry Ford and other industrialists of that era for substantially more than he had paid. In other words, Lord Duveen bought the one-of-a-kind masterpieces high and sold them much higher.

The point is, anyone can buy a mediocre piece of art for a low price, but the very best costs more. The very best stocks, like the very best art, usually command a higher price.

If a company's price and P/E ratio change in the near future, it's because conditions, events, psychology, and earnings have continued to improve or started to deteriorate. Eventually, a stock's P/E will reach a peak, but this normally occurs when the general market averages are topping out and starting a significant decline. It could also be a signal the company's rate of earnings growth is about to weaken.

It's true, high-P/E stocks will be more volatile, particularly if they're in the high-tech area. The price of a high-P/E stock can also temporarily get ahead of itself, but the same can be said for lower-P/E stocks.

Examples of High P/Es That Were Great Bargains

In situations where small but captivating growth companies have revolutionary new products, what seems like a high P/E ratio can actually be low. For instance,

- Xerox, which introduced the first dry copier in 1959, sold for 100 times earnings in 1960—*before* it advanced 3,300% in price (from a split-adjusted \$5 to \$170).
- Syntex, the first company to submit a patent for a birth control pill, sold for 45 times earnings in July 1963—before it advanced 400%.
- Genentech, a pioneer in the use of genetic information to develop new wonder drugs and the first biotech company to go public, was initially priced at 200 times earnings in November 1985. In five months, the new stock bolted 300%.
- America Online, whose software gave millions access to the revolutionary new world of the Internet, sold for over 100 times earnings in November 1994 before climbing 14,900% to its peak in December 1999.
- Google's P/E was in the 50s and 60s from \$115 a share in September 2004 until it hit \$475 a share in early January 2006.

The fact is, investors with a bias against what they consider to be high P/Es will miss out on some of the greatest opportunities of this or any other time. During bull markets, in particular, such a bias could literally cost you a fortune.

Don't Sell High-P/E Stocks Short

In June 1962, when the stock market was at rock bottom, a big Beverly Hills investor barged into the office of a broker friend of mine and shouted that, at 50 times earnings, Xerox was drastically overpriced. He proceeded to sell

2,000 shares short at \$88 (borrowing stock from his broker to sell in hopes the stock would decline and he could later buy it back cheaper, making money on the difference in price). Sure enough, the stock took off at once and ultimately reached a price of \$1,300 (before adjusting for splits) with a P/E ratio that topped 80.

So much for opinions about P/Es being too high! Investors' personal opinions are usually wrong; the market is almost always right. So stop fighting and arguing with the market.

You now possess a powerful secret to materially improve your stock selection and timing. Buy stocks with proven records of significant sales and earnings growth in each of the last three years plus strong recent quarterly improvements and a high return on equity. Get the best chart service you can find; learn to spot sound chart patterns and combine your new charting skill with the stocks with great earnings, sales, and return on equity. Don't accept anything less . . . if you want better results.

N = Newer Companies, New Products, New Management, New Highs Off Properly Formed Chart Bases

It takes something new to produce a startling advance in the price of a stock. It can be an important new product or service that sells rapidly and causes earnings to accelerate faster than previous rates of increase. Or it can be a change of management that brings new vigor, new ideas, or at least a new broom to sweep everything clean. New industry conditions—such as supply shortages, price increases, or the introduction of revolutionary technologies—can also have a positive effect on most stocks in an industry group.

In our study of the greatest stock market winners, which now spans the period from 1880 through 2008, we discovered that more than 95% of successful stocks with stunning growth in American industry fell into at least one of these categories. In the late 1800s, there was the new railroad industry connecting every part of our country, electricity, the telephone, and George Eastman's camera. Edison created the phonograph, the motion picture camera, and the lightbulb. Next came the auto, the airplane, and then the radio. The refrigerator replaced the icebox. Television, the computer, jet planes, the personal computer, fax machines, the Internet, cell phones . . . America's relentless inventors and entrepreneurs never quit. They built and created America's amazing growth record with their new products and new companies. These, in turn, created millions and millions of new jobs and a higher standard of living for the vast majority of Americans. In spite of bumps in the road, most Americans are unquestionably far better off than they or their parents were 25 or 40 years ago.

New Products That Created Super Successes

The way a company can achieve enormous success, thereby enjoying large gains in its stock price, is by introducing dramatic new products into the marketplace. I'm not talking about a new formula for dish soap. I'm talking about products that revolutionize the way we live. Here are just a few of the thousands of entrepreneurial companies that drove America and, during their time in the sun, created millions of jobs and a higher standard of living in the United States than in other areas of the world:

- 1.** Northern Pacific was chartered as the first transcontinental railroad. Around 1900, its stock rocketed more than 4,000% in just 197 weeks.
- 2.** General Motors began as the Buick Motor Company. In 1913–1914, GM stock increased 1,368%.
- 3.** RCA, by 1926, had captured the market for commercial radio. Then, from June 1927, when the stock traded at \$50, it advanced on a presplit basis to \$575 before the market collapsed in 1929.
- 4.** After World War II, Rexall's new Tupperware division helped push the company's stock to \$50 a share in 1958, from \$16.
- 5.** Thiokol came out with new rocket fuels for missiles in 1957–1959, propelling its shares from \$48 to the equivalent of \$355.
- 6.** Syntex marketed the oral contraceptive pill in 1963. In six months, the stock soared from \$100 to \$550.
- 7.** McDonald's, with low-priced fast-food franchising, snowballed from 1967 to 1971 to create a 1,100% profit for stockholders.
- 8.** Levitz Furniture's stock soared 660% in 1970–1971 on the popularity of the company's giant warehouse discount-furniture centers.
- 9.** Houston Oil & Gas, with a major new oil field, ran up 968% in 61 weeks in 1972–1973 and picked up another 367% in 1976.
- 10.** Computervision's stock advanced 1,235% in 1978–1980 with the introduction of its new CAD-CAM factory-automation equipment.
- 11.** Wang Labs' Class B shares grew 1,350% in 1978–1980 on the development of its new word-processing office machines.
- 12.** Price Company's stock shot up more than 15 times in 1982–1986 with the opening of a southern California chain of innovative wholesale warehouse membership stores.
- 13.** Amgen developed two successful new biotech drugs, Epogen and Neupogen, and the stock raced ahead from \$60 in 1990 to the equivalent of \$460 in early 1992.

- 14.** Cisco Systems, yet another California company, created routers and networking equipment that enabled companies to link up geographically dispersed local area computer networks. The stock rose nearly 2,000% from November 1990 to March 1994. In 10 years—1990 to 2000—it soared an unbelievable 75,000%.
- 15.** International Game Technology surged 1,600% in 1991–1993 with new microprocessor-based gaming products.
- 16.** Microsoft stock was carried up almost 1,800% from March 1993 to the end of 1999 as its innovative Windows software products dominated the personal computer market.
- 17.** PeopleSoft, the number one maker of personnel software, achieved a 20-fold increase in the 3½ years starting in August 1994.
- 18.** Dell Computer, the leader and innovator in build-to-order, direct PC sales, advanced 1,780% from November 1996 to January 1999.
- 19.** EMC, with superior computer memory devices, capitalized on the ever-increasing need for network storage and raced up 478% in the 15 months starting in January 1998.
- 20.** AOL and Yahoo!, the two top Internet leaders providing consumers with the new “portals” needed to access the wealth of services and information on the Internet, both produced 500% gains from the fall of 1998 to their peaks in 1999.
- 21.** Oracle’s database and e-business applications software drove its stock from \$20 to \$90 in only 29 weeks, starting in 1999.
- 22.** Charles Schwab, the number one online discount broker, racked up a 414% gain in just six months starting in late 1998, a period that saw a shift to online trading.
- 23.** Hansen Natural’s “Monster” energy drinks were a hit with the workout crowd, and Hansen Natural’s stock bolted 1,219% in only 86 weeks beginning in late 2004.
- 24.** Google gave the world instant information via the Internet, and its stock advanced 536% from its initial offering in 2004.
- 25.** Apple and the new iPod music player created a sensation that carried the company’s stock up 1,580% from a classic cup-with-handle base price pattern that was easy to spot on February 27, 2004—if you used charts.

And if you missed that last golden opportunity, you had four more classic base pattern chances to buy Apple: on August 27, 2004; July 15, 2005; September 1, 2006; and April 27, 2007—plus four more after March 2009.

In the years ahead, hundreds and thousands of new creative leaders just like these will continue to surface and be available for you to purchase. People from all over the world come to America to capitalize on its freedom and opportunity. That's one secret of our success that many countries do not have. So don't ever get discouraged and give up on the lifetime opportunity that the stock market will provide. If you study, save, prepare, and educate yourself, you too will be able to recognize many of the future big winners as they appear. You can do it, if you have the necessary drive and determination. It doesn't make any difference who you are or where you came from or your current position in life. It's all up to you. Do you want to get ahead?

The Stock Market's "Great Paradox"

There is another fascinating phenomenon we found in the early stage of all winning stocks. We call it the "Great Paradox." Before I tell you what it is, I want you to look at the accompanying graphs of three typical stocks.

Which one looks like the best buy to you, A, B, or C? Which would you avoid? We'll give you the answer at the end of this chapter.

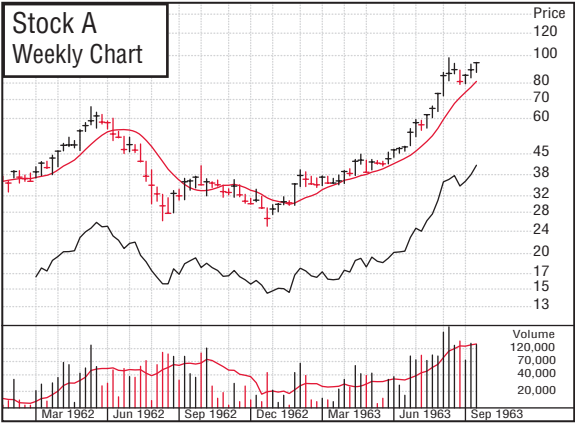
The staggering majority of individual investors, whether new or experienced, take delightful comfort in buying stocks that are down substantially from their peaks, thinking that they're getting a bargain. Among the hundreds of thousands of individual investors attending my investment lectures in the 1970s, 1980s, 1990s, and 2000s, many said that they do not buy stocks that are making new highs in price.

This bias is not limited to individual investors, however. I have provided extensive historical precedent research for more than 600 major institutional investors, and I have found that a number of them are also "bottom buyers." They, too, feel it's safer to buy stocks that look like bargains because they're either down a lot in price or actually selling near their lows.

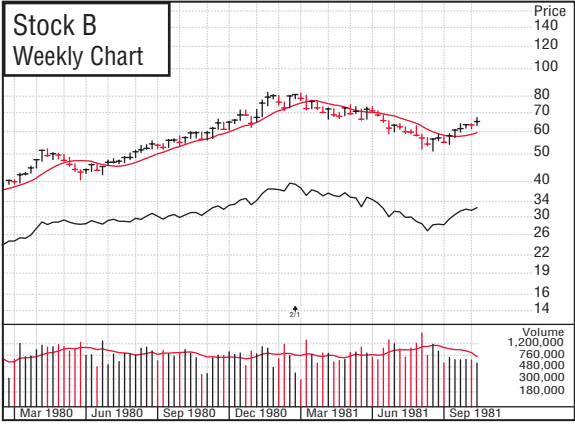
Our study of the greatest stock market winners proved that the old adage "buy low, sell high" was completely wrong. In fact, our study proved the exact opposite. The hard-to-believe Great Paradox in the stock market is

What seems too high in price and risky to the majority usually goes higher eventually, and what seems low and cheap usually goes lower.

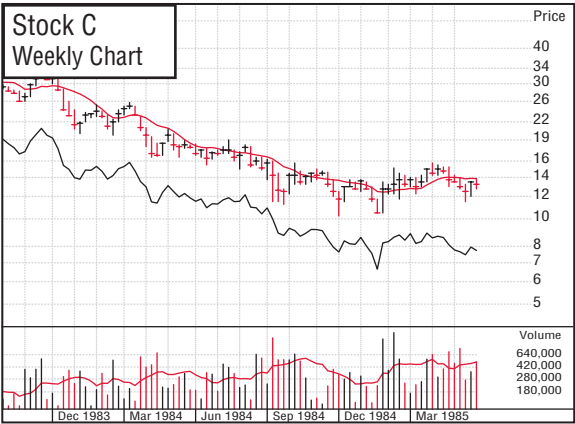
Are you finding this "high-altitude paradox" a little difficult to act upon? Let me cite another study we conducted. In this one, we analyzed two groups of stocks—those that made new highs and those that made new lows—over many bull market periods. The results were conclusive: stocks on the new-high list tended to go higher in price, while those on the new-low list tended to go lower.



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Based on our research, a stock on *Investor's Business Daily's* “new price low” list tends to be a pretty poor prospect and should be avoided. In fact, decisive investors should sell such stocks long before they ever get near the new-low list. A stock making the new-high list—especially one making the list for the first time while trading on big volume during a bull market—might be a prospect with big potential.

How Does a Stock Go from \$50 to \$100?

If you can't bring yourself to buy a stock at a level it has never before achieved, ask yourself: What does a stock that has traded between \$40 and \$50 a share over many months, and is now selling at \$50, have to do to double in price? Doesn't it first have to go through \$51, then \$52, \$53, \$54, \$55, and so on—all new price highs—before it can reach \$100?

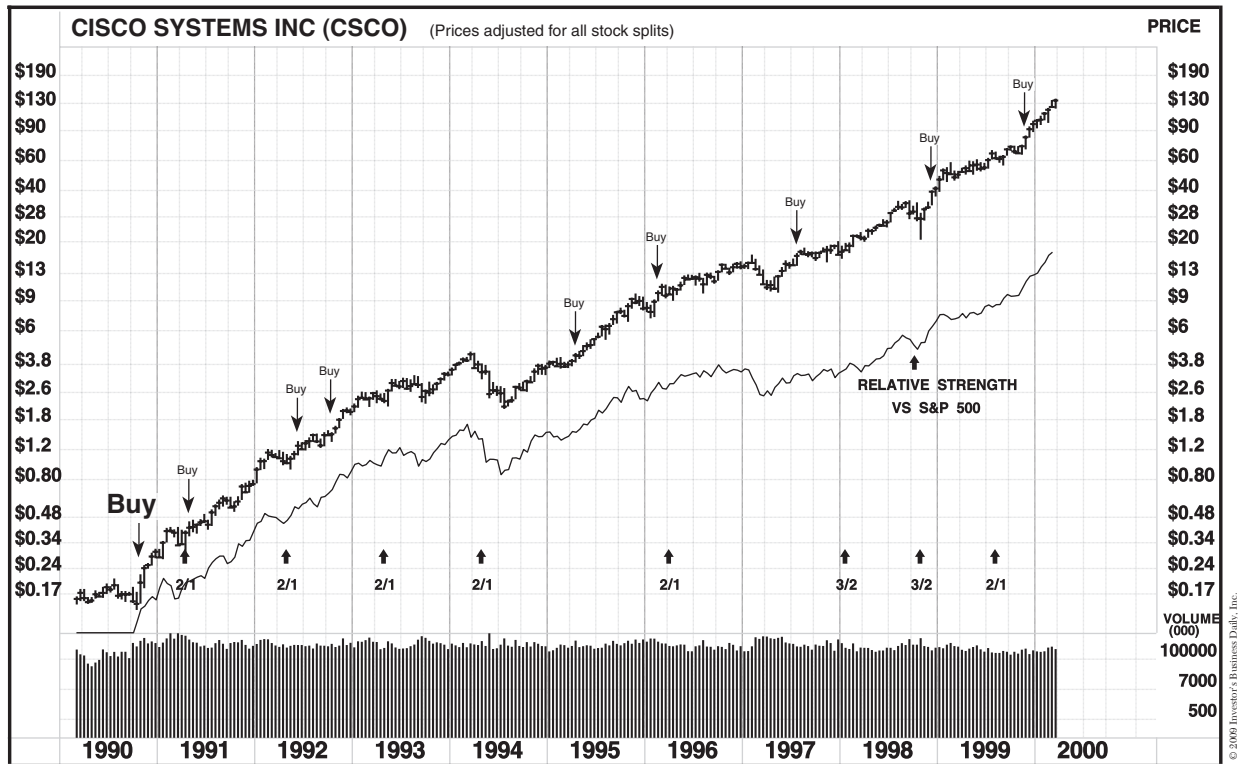
As a smart investor, your job is to buy when a stock looks too high to the majority of conventional investors and sell after it moves substantially higher and finally begins to look attractive to some of those same investors. If you had bought Cisco in November of 1990 at the highest price it had ever sold for, when it had just made a new high and looked scary, you would have enjoyed a nearly 75,000% increase from that point forward to its peak in the year 2000.

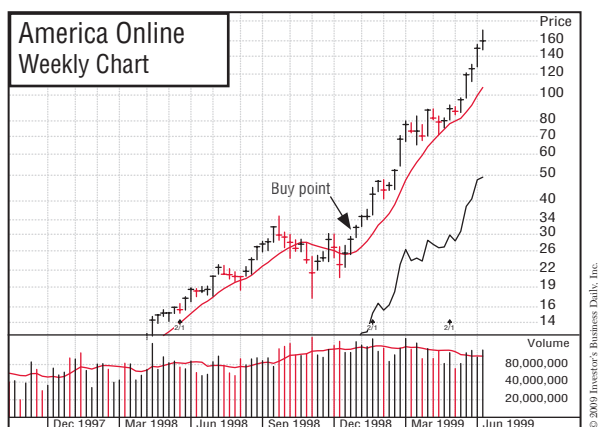
The Correct Time to Begin Buying a Stock

Just because a stock is making a new price high doesn't necessarily mean that this is the right time to buy. Using stock charts is an important piece of the stock selection process. A stock's historical price movement should be reviewed carefully, and you should look for stocks that are making new price highs as they break out of proper, correct bases. (Refer back to Chapter 2 for more detail on reading charts and identifying chart patterns.) The 100 great full-page examples in Chapter 1 should have given you a real head start.

These correctly created breakouts are the points at which most really big price advances begin and the possibility of a significant price move is the greatest. A sound consolidation, or base-building, period could last from seven or eight weeks up to 15 months.

As noted in Chapter 2, the perfect time to buy is during a bull market just as a stock is starting to break out of its price base. (See the America Online chart on page 178.) If the stock is more than 5% or 10% above the exact buy point off the base, it should be avoided. Buying it at this level greatly increases the chance of getting shaken out in the next normal correction or sharp pullback in price. You can't just buy the best stocks any old time. There's a right time, and then there are all the other times.

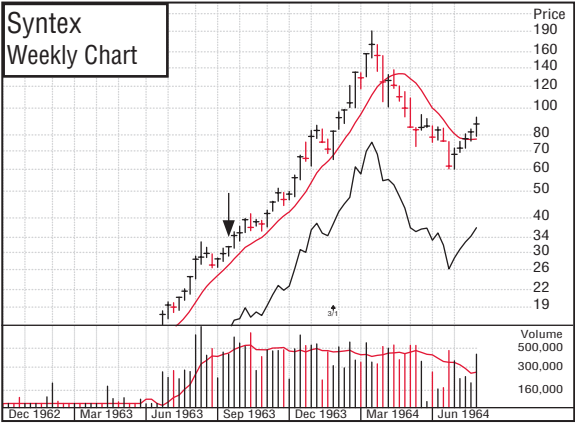




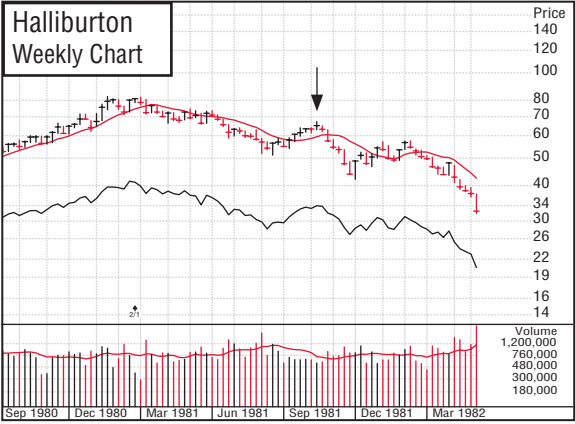
Answers to the Market's Great Paradox

Now that you know the Great Paradox, would you still pick the same stock you did earlier in the chapter? The right one to buy was Stock A, Syntex Corp., which is shown on the next page. The arrow pointing to July 1963's weekly price movements indicates the buy point. This arrow coincides with the price and volume activity at the end of the Stock A chart, adjusted for a 3-for-1 split. Syntex enjoyed a major price advance from its July 1963 buy point. In contrast, Stocks B (Halliburton) and C (Comdata Network) both declined, as you can see from the charts given on the next page. (The arrows indicate where the corresponding charts shown earlier left off.)

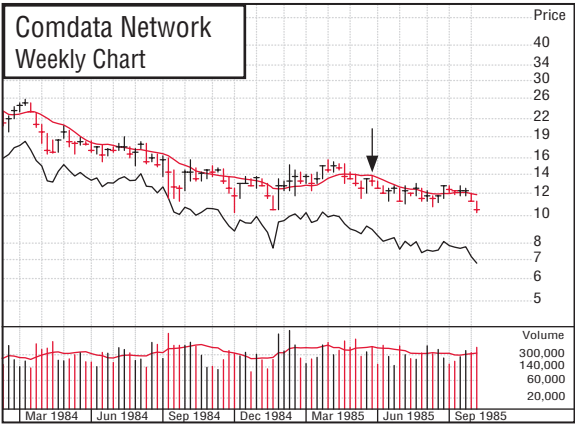
Search for companies that have developed important new products or services, or that have benefited from new management or materially improved industry conditions. Then buy their stocks when they are emerging from sound, correctly analyzed price consolidation patterns and are close to, or actually making, new price highs on increased volume.



Stock A: 482% increase in 6 months from buy arrow.



Stock B: down 42% in 6 months from arrow.



Stock C: down 21% in 5 months from arrow.

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S = Supply and Demand: Big Volume Demand at Key Points

The price of almost everything in your daily life is determined by the law of supply and demand. What you pay for your lettuce, tomatoes, eggs, and beef depends on how much of each is available and how many people want these items. Even in former Communist countries, where the difference between haves and have-nots was theoretically nonexistent, supply and demand held sway. There, state-owned goods were always in short supply and were often available only to the privileged class or on the black market to those who could pay the exorbitant prices.

This basic principle of supply and demand also applies to the stock market, where it is more important than the opinions of all the analysts on Wall Street, no matter what schools they attended, what degrees they earned, or how high their IQs.

Big or Small Supply of Stock

It's hard to budge the price of a stock that has 5 billion shares outstanding because the supply is so large. Producing a rousing rally in these shares would require a huge volume of buying, or demand. On the other hand, it takes only a reasonable amount of buying to push up the price of a stock with 50 million shares outstanding, a relatively smaller supply.

So if you're choosing between two stocks to buy, one with 5 billion shares outstanding and the other with 50 million, the smaller one will usually be the better performer, if other factors are equal. However, since smaller-cap-

italization stocks are less liquid, they can come down as fast as they go up, sometimes even faster. In other words, with greater opportunity comes significant additional risk. But there are definite ways of minimizing your risk, which will be discussed in Chapters 10 and 11.

The total number of shares outstanding in a company's capital structure represents the potential amount of stock available. But market professionals also look at the "floating supply"—the number of shares that are available for possible purchase after subtracting stock that is closely held. Companies in which top management owns a large percentage of the stock (at least 1% to 3% in a large company, and more in small companies) generally are better prospects because the managers have a vested interest in the stock.

There's another fundamental reason, besides supply and demand, why companies with a large number of shares outstanding frequently produce slower results: the companies themselves may be much older and growing at a slower rate. They are simply too big and sluggish.

In the 1990s, however, bigger-capitalization stocks outperformed small-cap issues for several years. This was in part related to the size problem experienced by the mutual fund community. It suddenly found itself awash in new cash as more and more people bought funds. As a result, larger funds were forced to buy more bigger-cap stocks. This need to put their new money to work made it appear that they favored bigger-cap issues. But this was contrary to the normal supply/demand effect, which favors smaller-cap stocks with fewer shares available to meet increases in institutional investor demand.

Big-cap stocks do have some advantages: greater liquidity, generally less downside volatility, better quality, and in some cases less risk. And the immense buying power that large funds have these days can make top-notch big stocks advance nearly as fast as shares of smaller companies.

Pick Entrepreneurial Management Rather than Caretakers

Big companies may seem to have a great deal of power and influence, but size often begets a lack of imagination and productive efficiency. Large companies are often run by older and more conservative "caretaker managements" that are less willing to innovate, take risks, and move quickly and wisely to keep up with rapidly changing times. In most cases, top managers of large companies don't own a lot of their company's stock. This is a serious deficiency that should be corrected. To the savvy investor, it suggests that the company's management and employees don't have a personal interest in seeing the company succeed. In some cases, large companies also have multiple layers of management that separate senior executives from what's

going on at the customer level. And for companies competing in a capitalist economy, the ultimate boss is the customer.

Communication of information continues to change at an ever-faster rate. A company that has a hot new product today will find its sales slipping within two or three years if it doesn't continue to bring relevant, superior new products to market. Most new products, services, and inventions come from young, hungry, and innovative small- and medium-sized companies with entrepreneurial management. Not coincidentally, these smaller public and nonpublic companies grow faster and create somewhere between 80% and 90% of the new jobs in the United States. Many of them are in the service or technology and information industries. This is possibly where the great future growth of America lies. Microsoft, Cisco Systems, and Oracle are just a few examples of dynamic small-cap innovators of the 1980s and 1990s that continually grew and eventually became big-cap stocks.

If a mammoth older company creates an important new product, it may not help the stock materially because the product will probably account for only a small percentage of the company's total sales and earnings. The product is simply a small drop in a bucket that's now just too big.

Excessive Stock Splits May Hurt

From time to time, companies make the mistake of splitting their stocks excessively. This is sometimes done on advice from Wall Street investment bankers. In my opinion, it's usually better for a company to split its shares 2-for-1 or 3-for-2 than to split them 3-for-1 or 5-for-1. (When a stock splits 2-for-1, you get two shares for each share you previously held, but the new shares sell for half the price.) Oversized splits create a substantially larger supply and may put a company in the more lethargic, big-cap status sooner.

Incidentally, a stock will usually end up moving higher after its first split in a new bull market. But before it moves up, it will go through a correction for a period of weeks.

It may be unwise for a company whose stock has gone up in price for a year or two to declare an extravagant split near the end of a bull market or in the early stage of a bear market. Yet this is exactly what many corporations do.

Generally speaking, these companies feel that lowering the share price of their stock will attract more buyers. This may be the case with some smaller buyers, but it also may produce the opposite result—more sellers—especially if it's the second split within a year or two. Knowledgeable pros and a few shrewd individual traders will probably use the excitement

generated by the oversized split as an opportunity to sell and take their profits. In addition, large holders who are thinking of selling might figure it will be easier to unload their 100,000 shares before a 3-for-1 split than to sell 300,000 shares afterward. And smart short sellers pick on stocks that are heavily owned by institutions and are starting to falter after huge price run-ups.

A stock will often reach a price top around the second or third time it splits. Our study of the biggest winners found that only 18% of them had splits in the year preceding their great price advances. Qualcomm topped in December 1999, just after its 4-for-1 stock split.

Look for Companies Buying Their Own Stock in the Open Market

In most but not all cases, it's usually a good sign when a company, especially a small- to medium-sized growth company that meets the CAN SLIM criteria, buys its own stock in the open market consistently over a period of time. (A 10% buyback would be considered big.) This reduces the number of shares and usually implies that the company expects improved sales and earnings in the future.

As a result of the buyback, the company's net income will be divided by a smaller number of shares, thereby increasing earnings per share. And as already noted, the percentage increase in earnings per share is one of the principal driving forces behind outstanding stocks.

From the mid-1970s to the early 1980s, Tandy, Teledyne, and Metromedia successfully repurchased their own stock, and all three achieved higher EPS growth and spectacular stock gains. Charles Tandy once told me that when the market went into a correction, and his stock was down, he would go to the bank and borrow money to buy back his stock, then repay the loans after the market recovered. Of course, this was also when his company was reporting steady growth in earnings.

Tandy's (split-adjusted) stock increased from \$2.75 to \$60 in 1983, Metromedia's soared from \$30 in 1971 to \$560 in 1977, and Teledyne zoomed from \$8 in 1971 to \$190 in 1984. Teledyne used eight separate buybacks to shrink its capitalization from 88 million shares to 15 million and increase its earnings from \$0.61 a share to nearly \$20.

In 1989 and 1990, International Game Technology announced that it was buying back 20% of its stock. By September 1993, IGT had advanced more than 20 times. Another big winner, home builder NVR Inc., had large buybacks in 2001. All these were growth companies. I'm not sure that company buybacks when earnings are not growing are all that sound.

A Low Corporate Debt-to-Equity Ratio Is Generally Better

After you've found a stock with a reasonable number of shares, check the percentage of the company's total capitalization represented by long-term debt or bonds. Usually, the lower the debt ratio, the safer and better the company. The earnings per share of companies with high debt-to-equity ratios could be clobbered in difficult periods when interest rates are high or during more severe recessions. These highly leveraged companies are generally of lower quality and carry substantially higher risk.

The use of extreme leverage of up to 40-to-1 or 50-to-1 was common among banks, brokers, mortgage lenders, and quasi-government agencies like Fannie Mae and Freddie Mac starting in 1995 and continuing until 2007. These institutions were strongly encouraged by the federal government's actions to invest large amounts of money in subprime loans to lower-income buyers, which ultimately led to the financial and credit crisis in 2008.

Rule 1 for all competent investors and homeowners is never ever borrow more than you can pay back. Excessive debt hurts all people, companies, and governments.

A corporation that's been reducing its debt as a percentage of equity over the last two or three years is worth considering. If nothing else, interest costs will be sharply reduced, helping to generate higher earnings per share.

Another thing to watch for is the presence of convertible bonds in the capital structure; earnings could be diluted if and when the bonds are converted into shares of common stock.

Evaluating Supply and Demand

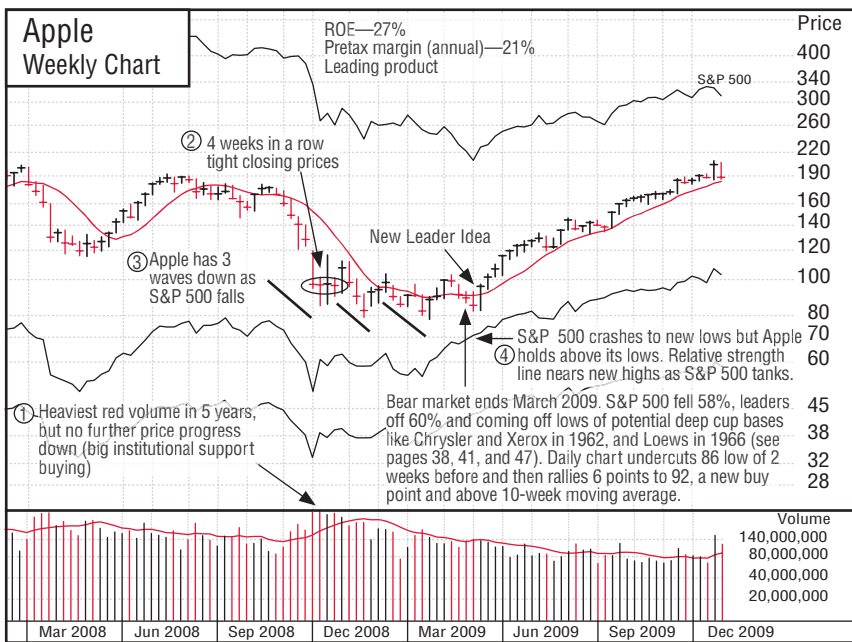
The best way to measure a stock's supply and demand is by watching its daily trading volume. This is uniquely important. It's why *Investor's Business Daily's* stock tables show both a stock's trading volume each day and the percentage volume is above or below the stock's average daily volume in the last three months. These facts, plus a proprietary rating of the amount of recent accumulation or distribution in the stock, are key information available in no other daily publication, including the *Wall Street Journal*.

When a stock pulls back in price, you typically want to see volume dry up at some point, indicating there is no further selling pressure. When the stock rallies in price, in most situations you want to see volume rise, which usually represents buying by institutions, not the public.

When a stock breaks out of a price consolidation area (see Chapter 2 on chart reading of price patterns of winning stocks), trading volume should

jump 40% or 50% above normal. In many cases, it will be 100% or more that day, indicating solid buying and likely further price increases. Using daily, weekly, and monthly charts helps you analyze and interpret a stock's price and volume action.

You should analyze a stock's base pattern week by week, beginning with the first week a stock closes down in a new base and continuing each week until the current week, where you think it may break out of the base. You judge how much price progress up or down the stock made each week and whether it was on increased or decreased volume from the prior week. You also note where the stock closed within the price spread of each week's high and low. You do both a week-by-week check and evaluate the pattern's overall shape to see if it is sound and under accumulation or if it has too many defects.



How Our Institutional Leaders Service Picked Apple at \$92 on March 11, 2009

Any size capitalization can be bought using the CAN SLIM system. But small-cap stocks will be a lot more volatile. From time to time, the market shifts emphasis from small to large caps. Companies buying back their stock in the open market and showing stock ownership by management are preferred.

L = Leader or Laggard: Which Is Your Stock?

People tend to buy stocks that make them feel either good or comfortable. But in a bull market populated by dynamic leaders that just keep surprising on the upside, these sentimental favorites often turn out to be the duller laggards.

Suppose you want to own a stock in the computer industry. If you buy the best performer in the group, and your timing is right, you have a crack at real price appreciation. But if you buy a stock that hasn't moved much, or that has even fallen to a price that makes it seem like a bargain and therefore safer, chances are that you've picked a stock with little potential. There's a reason, after all, that it's at the bottom of the pile.

Don't just dabble in stocks, buying what you like for whatever reason. Dig in, do some detective work, and find out what makes some stocks go up much more than others. You can do it, if you work at it.

Buy Among the Best Two or Three Stocks in a Group

The top one, two, or three stocks in a strong industry group can have unbelievable growth, while others in the pack may hardly stir.

The great computer stocks in the bull market of 1979 and 1980—Wang Labs, Prime Computer, Datapoint, Rolm, and Tandy—had five-, six-, and sevenfold advances before they topped and retreated. But the sentimental favorite, grand old IBM, just sat there, and giants Burroughs, NCR, and Sperry Rand were just as lifeless. In the bull market of 1981–1983, however, IBM sprang to life and produced excellent results.

In the retail sector, Home Depot advanced 10 times from 1988 to 1992, while the laggards in the home-improvement niche, Waban and Hechinger, dramatically underperformed.

You should buy the really great companies—those that lead their industries and are number one in their particular fields. All of my best big winners—Syntex in 1963, Pic ‘N’ Save from 1976 to 1983, Price Co. from 1982 to 1985, Franklin Resources from 1985 to 1986, Genentech from 1986 to 1987, Amgen from 1990 to 1991, America Online from 1998 to 1999, Charles Schwab from 1998 to 1999, Sun Microsystems from 1998 to 1999, Qualcomm in 1999, eBay from 2002 to 2004, Google from 2004 to 2007, and Apple from 2004 to 2007—were the number one companies in their industry space at the time I purchased them.

By number one, I don’t mean the largest company or the one with the most recognized brand name. I mean the one with the best quarterly and annual earnings growth, the highest return on equity, the widest profit margins, the strongest sales growth, and the most dynamic stock-price action. This type of company will also have a unique and superior product or service and be gaining market share from its older, less-innovative competitors.

Avoid Sympathy Stocks, Buy New Innovative Leaders

Our studies show that very little in the stock market is really new; history just keeps repeating itself.

When I first bought stock in Syntex, the developer of the birth-control pill, in July 1963 off a high, tight flag pattern (and it then rapidly shot up 400%), most people wouldn’t touch it. The stock had just made a new price high at \$100 on the American Stock Exchange, and its price plus its P/E ratio, 45, made it seem too high and scary. No brokerage firms had research reports on it then, and the only mutual fund that owned it—a Value Line fund—had sold it the prior quarter when it began moving up. Instead, several Wall Street investment firms later recommended G. D. Searle as a “sympathy play.” Searle had a product similar to Syntex’s, and its stock looked much cheaper because it hadn’t gone up as much. But its stock failed to produce the same results. Syntex was the leader; Searle the laggard.

A sympathy play is a stock in the same industry group that is bought in the hope that the luster of the real leader will rub off on it. But the profits of such companies usually pale in comparison. The stocks will eventually try to move up “in sympathy” with the leader, but they never do as well.

In 1970, Levitz Furniture, the leader in the then-new warehouse business, became an electrifying market winner. Wickes Corp. copied Levitz, and many people bought its shares because they were “cheaper,” but Wickes

never performed and ultimately got into financial trouble. Levitz, meanwhile, appreciated 900% before it finally topped.

As steel industry pioneer Andrew Carnegie said in his autobiography: “The first man gets the oyster; the second, the shell.” Each new business cycle in America is driven by new innovators, inventors, and entrepreneurs.

If our government really wants to create jobs and not welfare packages, the most powerful way would be to provide strong tax incentives for the first two or three years to people who want to start new, small entrepreneurial businesses. Our data show that in the last 25 years, small businesses in America were responsible for creating 80% to 90% of all new jobs. This is a significantly higher percentage than that shown in government data, where new jobs are not accounted for in a realistic, comprehensive manner.

For example, the Small Business Administration defines a small business as one with fewer than 500 people. Yes, when Sam Walton started Wal-Mart and Bill Gates started Microsoft, each company had maybe 30 or 40 people. A year later they had maybe 75, the next year 120, then 200, then 320, then 501. From that point on, they were no longer considered to be small companies. But over the next 10 or 15 years, one of them created more than a million jobs and the other 500,000 jobs. Those jobs were all created by a dynamic entrepreneur who started a brand-new company, and they should be recognized and counted as such.

We have a huge database on all public companies. In the past 25 years, big business created no net new jobs. When a big business buys another company, thereby instantly padding its payrolls, it doesn’t create *new* jobs. In fact, it usually consolidates and lays off people in duplicative positions. Many such companies also downsize over time. Our inefficient, bureaucratic government needs to start counting all jobs created by new or small businesses during their first 15 or 20 years in business.

How to Separate the Leaders from the Laggards: Using Relative Price Strength

If you own a portfolio of stocks, you must learn to sell the worst performers first and keep the best a little longer. In other words, always sell your mistakes while the loss is still small, and watch your better selections to see if they progress into your big winners. Human nature being what it is, most people do it backwards: they hold their losers and sell their winners, a formula that always leads to bigger losses.

How do you tell which stock is better and which is worse? The fastest and easiest way is by checking its Relative Price Strength (RS) Rating in *Investor’s Business Daily*.

The proprietary RS Rating measures the price performance of a given stock against the rest of the market for the past 52 weeks. Every stock in the market is assigned a rating from 1 to 99, with 99 being best. An RS Rating of 99 means that the stock has outperformed 99% of all other companies in terms of price performance. A RS of 50 means that half of all other stocks have done better and half have done worse.

If your stock's RS Rating is below 70, it is lagging the better-performing stocks in the overall market. That doesn't mean that it can't go up in price. It just means that if by some chance it does go up, it'll probably go up less.

From the early 1950s through 2008, the average RS Rating of the best-performing stocks *before* their major run-ups was 87. In other words, the best stocks were already doing better than nearly 9 out of 10 others when they were starting out on their most explosive advance yet. So the rule for those who are determined to be big winners in the stock market is: look for the genuine leaders and avoid laggards and sympathy plays. Don't buy stocks with Relative Strength Ratings in the 40s, 50s, or 60s.

The Relative Price Strength Rating is shown each day for all stocks listed in *Investor's Business Daily's* stock tables. You can't find this information in any other daily business or local newspaper. Updated RS Ratings are also shown on the Daily Graphs Online charting service.

A stock's relative strength can also be plotted on a chart. If the RS line has been sinking for seven months or more, or if the line has an abnormally sharp decline for four months or more, the stock's price behavior is highly questionable, and it should probably be sold.

Pick 80s and 90s That Are in Sound and Proper Base Patterns

If you want to upgrade your stock selection so that you're zeroing in on the leaders, restrict your purchases to companies showing RS Ratings of 80 or higher. There's no point in buying a stock that's straggling behind. Yet that's exactly what many investors do—including some who work at America's largest investment firms.

I don't like to buy stocks with Relative Price Strength Ratings less than 80. In fact, the really big moneymakers generally have RS Ratings of 90 or higher just before they break out of their first or second base structure. The RS Rating of a potential winning stock should be in the same league as a pitcher's fastball. The average big-league fastball is clocked at 86 miles per hour, and the best pitchers throw "heat" in the 90s.

When you buy a stock, make absolutely sure that it's coming out of a sound base or price consolidation area. Also make sure that you buy it at its exact buy, or pivot, point. As mentioned before, avoid buying stocks that are extended more than 5% or 10% above the precise initial buy point. This will keep you from chasing stocks that race up in price too rapidly and makes it less likely that you will be shaken out during sharp market sell-offs.

The unwillingness of investors to set and follow minimum standards for stock selection reminds me of doctors years ago who were ignorant of the need to sterilize their instruments before each operation. They kept killing off patients until surgeons finally and begrudgingly accepted studies by researchers Louis Pasteur and Joseph Lister. Ignorance rarely pays off in any walk of life, and it's no different in the stock market.

Finding New Leaders during Market Corrections

Corrections, or price declines, in the general market can help you recognize new leaders—if you know what to look for. The more desirable growth stocks normally correct 1½ to 2½ times the general market averages. In other words, if the overall market comes down 10%, the better growth stocks will correct 15% to 25%. However, in a correction during a bull, or upward-trending, market, the growth stocks that decline the least (percentagewise) are usually your best selections. Those that drop the most are normally the weakest.

Say the general market average suffers an intermediate-term correction of 10%, and three of your successful growth stocks come off 15%, 25%, and 35%. The two that are off only 15% or 25% are likely to be your best investments after they recover. A stock that slides 35% to 40% in a general market decline of 10% could be flashing a warning signal. In most cases, you should heed it.

Once a general market decline is definitely over, the first stocks that bounce back to new price highs are almost always your authentic leaders. These chart breakouts continue week by week for about 13 weeks. The best ones usually come out in the first three or four weeks. This is the ideal period to buy stocks . . . you absolutely don't want to miss it. Be sure to read the chapter on general market direction carefully to learn how you determine it.

Pros Make Many Mistakes Too

Many professional investment managers make the serious mistake of buying stocks that have just suffered unusually large price drops. Our studies indicate that this is a surefire way to get yourself in trouble.

In June 1972, an otherwise capable institutional investor in Maryland bought Levitz Furniture after its first abnormal price break—a one-week drop from \$60 to around \$40. The stock rallied for a few weeks, then rolled over and broke to \$18.

In October 1978, several institutional investors bought Memorex, a leading supplier of computer peripheral equipment, when it had its first unusual price break and looked to be a real value. It later plunged.

In September 1981, certain money managers in New York bought Dome Petroleum on a break from \$16 to \$12. To them, it seemed cheap, and a favorable story about the stock was going around Wall Street. Months later, Dome sold for \$1.

Institutional buyers snapped up Lucent Technologies, a Wall Street darling after it was spun off from AT&T in the mid-1990s, after it broke from \$78 to \$50. Later that year, it collapsed to \$5.

Also in 2000, many people bought Cisco Systems when it dropped to \$50 from its early-year high of \$82. The maker of computer networking equipment had been a huge winner in the 1990s, when it soared 75,000%, so it looked cheap at \$50. It went to \$8 and never got back to \$50. In 2008, eight years after those buyers saw value at \$50, Cisco was selling for only \$17. To do well in the stock market, you've got to stop doing what got you into trouble in the past and create new and far better rules and methods to guide you in the future.

Suppose Joe Investor missed buying Crocs, the footwear company, at a split-adjusted \$15 as it came out of the perfect cup-with-handle pattern in September 2006. Suppose he also missed the next cup pattern in April 2007 at 28. Then the stock roars up to \$75 by October, with earnings up 100% every quarter. A month later, however, the stock drops to 47, and Joe sees his chance to get into this big winner that he missed all the way up and that's now at a cheaper price. But the stock just keeps falling, and by January 2009 it's trading at \$1. Buying stocks on the way down is dangerous. You can get wiped out. So stop this risky bad habit.

How about buying a blue chip, a top-flight bank that's a leader in its industry—Bank of America? In December 2006, it was \$55 a share, but you could have gotten it cheaper a year later at \$40. Another year later, however, it had plunged to \$6. But you're still a long-term investor, getting your 4-cent dividend.

This is why I say don't buy a supposed good stock on the way down and why we recommend cutting all losses at 7% or 8%. Any stock can do anything. You must have rules to protect your hard-earned money. We all make mistakes. You must learn to correct yours without vacillating.

None of the pros or individual investors who owned or bought Cisco, Crocs, or BofA when they were falling recognized the difference between

normal price declines and highly abnormal big-volume corrections that can signal potential disaster. But the real problem was they relied on stories they'd heard and a method of fundamental analysis that equates lower P/E ratios with "value." They didn't heed the market action that could have told them what was really going on.

Those who listen and learn the difference between normal and abnormal action are said to have a "good feel for the market." Those who ignore what the market says usually pay a heavy price. Anyone who buys stocks on the way down in price because they look cheap will learn the hard way this is how you can lose a lot of money.

Look for Abnormal Strength on a Weak Market Day

In the spring of 1967, I remember walking through a broker's office in New York on a day when the Dow Jones Industrial Average was down more than 12 points. That was a lot in those days, when the Dow was around 800 compared with 8,000 in 2008. When I looked up at the electronic ticker tape moving across the wall and showing prices, I saw that Control Data—a pioneer in supercomputers—was trading at \$62, up 3½ points on heavy volume. I bought the stock at once. I knew Control Data well, and this was highly abnormal strength in the face of a weak overall market. The stock later ran up to \$150.

In April 1981, just as the 1981 bear market was getting under way, MCI Communications, a telecommunications stock trading in the over-the-counter market, broke out of a price base at \$15. It advanced to the equivalent of \$90 in 21 months. This was another great example of highly abnormal strength during a weak market.

Lorillard, the tobacco company, did the same thing in the 1957 bear market, Software Toolworks soared in the down market of early 1990, wireless telecom firm Qualcomm made big progress even during the difficult midyear market of 1999, and Taro Pharmaceutical late in 2000 bucked the bear market that had begun that spring. Also in 2000, home builder NVR took off at \$50 and rode steadily lower interest rates up to \$360 by March 2003. The new bull market in 2003 uncovered many leaders, including Apple, Google, Research in Motion, Potash, and several Chinese stocks.

So don't forget: **It seldom pays to invest in laggard stocks, even if they look tantalizingly cheap. Look for, and confine your purchases to, market leaders. Get out of your laggard losers if you're down 8% below the price you paid so that you won't risk getting badly hurt.**

I = Institutional Sponsorship

It takes big demand to push up prices, and by far the biggest source of demand for stocks is institutional investors, such as mutual funds, pension funds, hedge funds, insurance companies, large investment counselors, bank trust departments, and state, charitable, and educational institutions. These large investors account for the lion's share of each day's market activity.

What Is Institutional Sponsorship?

Institutional sponsorship refers to the shares of any stock owned by such institutions. For measurement purposes, I have never considered brokerage research reports or analyst recommendations as institutional sponsorship, although a few may exert short-term influence on some securities for a few days. Investment advisory services and market newsletters also aren't considered to be institutional or professional sponsorship by this definition because they lack the concentrated or sustained buying or selling power of institutional investors.

A winning stock doesn't need a huge number of institutional owners, but it should have several at a minimum. Twenty might be a reasonable minimum number in a few rare cases involving small or newer companies, although most stocks have many, many more. If a stock has no professional sponsorship, chances are that its performance will be more run-of-the-mill, as this means that at least some of the more than 10,000 institutional investors have looked at the stock and passed over it. Even if they're wrong, it still takes large buying volume to stimulate an important price increase.

Look for Both Quality and Increasing Numbers of Buyers

Diligent investors dig down yet another level. They want to know not only how *many* institutional sponsors a stock has, but whether that number has steadily increased in recent quarters, and, more important, whether the most recent quarter showed a materially larger increase in the number of owners. They also want to know *who* those sponsors are, as shown by services reporting this information. They look for stocks that are held by at least one or two of the more savvy portfolio managers who have the best performance records. This is referred to as analyzing the *quality* of sponsorship.

In analyzing the recorded quality of a stock's institutional sponsorship, the latest 12 months plus the last three years of the investment performance of mutual fund sponsors are usually most relevant. A quick and easy way to get this information is by checking a mutual fund's 36-Month Performance Rating in *Investor's Business Daily*. An A+ rating indicates that a fund is in the top 5% in terms of performance. Funds with ratings of B+ or higher are considered the better performers. Keep in mind that the rating of a good growth stock mutual fund may be a little lower during a bear market, when most growth stocks will definitely correct.

Results may change significantly, however, if key portfolio managers leave one money-management firm and go to another. The leaders in the ratings of top institutional mutual funds generally rotate and change slowly as the years go by.

Several financial services publish fund holdings and the investment performance records of various institutions. For example, you can learn the top 25 holdings of each fund plus other data at Morningstar.com. In the past, mutual funds tended to be more aggressive in the market. More recently, new "entrepreneurial-type" investment-counseling firms have cropped up to manage public and institutional money.

Buy Companies That Show Increasing Sponsorship

As mentioned earlier, it's less crucial to know *how many* institutions own a stock than to know *which* of the limited number of better-performing institutions own a stock or have bought it recently. It's also key to know whether the total number of sponsors is increasing or decreasing. The main thing to look for is the recent quarterly trend. It's always best to buy stocks showing strong earnings and sales and an increasing number of institutional owners over several recent quarters.

Note New Stock Positions Bought in the Last Quarter

A significant new position taken by an institutional investor in the most recently reported period is generally more relevant than existing positions that have been held for some time. When a fund establishes a new position, chances are that it will continue to add to that position and be less likely to sell it in the near future. Reports on such activities are available about six weeks after the end of a fund's three- or six-month period. They are helpful to those who can identify the wiser picks and who understand correct timing and proper analysis of daily and weekly charts.

Many investors feel that disclosures of a fund's new commitments are published too long after the fact to be of any real value. But these individual opinions typically aren't correct.

Institutional trades also tend to show up on some ticker tapes as transactions of from 1,000 to 100,000 shares or more. Institutional buying and selling can account for up to 70% of the activity in the stocks of most leading companies. This is the sustained force behind most major price moves. About half of the institutional buying that shows up on the New York Stock Exchange ticker tape may be in humdrum stocks. Much of it may also be wrong. But out of the other half, you may have several truly phenomenal selections.

Your task, then, is to separate intelligent, highly informed institutional buying from poor, faulty buying. This is hard at first, but it will get easier as you learn to apply and follow the proven rules, guidelines, and principles presented in this book.

To get a better sense for what works in the market, it's important to study the investment strategies of a well-managed mutual fund. When reviewing the tables in *Investor's Business Daily*, look for growth funds with A, A-, or B+ ratings during bull markets and then call to obtain a prospectus. From the prospectus, you'll learn the investment philosophy and techniques used by the individual funds as well as the type and caliber of stocks they've purchased. For example:

- Fidelity's Contrafund, managed by Will Danoff, has been the best-performing large, multibillion-dollar fund for a number of years. He scours the country and international equities to get in early on every new concept or story in a stock.
- Jim Stower's American Century Heritage and Gift Trust funds use computers to find aggressive stocks with accelerating percentage increases in recent sales and earnings.
- Ken Heebner's CGM Focus and CGM Mutual have both had superior results for many years. His Focus fund concentrates in only 20 stocks.

This makes it more volatile, but Ken likes to make big sector bets that in most cases have worked very well for him.

- Jeff Vinik was a top-flight manager at Fidelity who left and started what is regarded as one of the country's best-performing hedge funds.
- Janus 20, headquartered in Denver, runs a concentrated portfolio of fewer than 30 growth stocks.

Some funds buy on new highs; others buy around lows and may sell on new highs. New fund leaders can emerge over time.

Is Your Stock “Overowned” by Institutions?

It's possible for a stock to have too much institutional sponsorship. *Overowned* is a term we coined in 1969 to describe stocks in which institutional ownership has become excessive. The danger is that excessive sponsorship might translate into large potential selling if something goes wrong at the company or if a bear market begins.

Janus Funds alone owned more than 250 million shares of Nokia and 100 million shares of America Online, which contributed to an adverse supply/demand imbalance in 2000 and 2001. WorldCom (in 1999) and JDS Uniphase and Cisco Systems (in 2000 and 2001) were other examples of overowned stocks.

Thus, the “Favorite 50” and other widely owned institutional stocks can be poor, risky prospects. By the time a company's strong performance is so obvious that almost all institutions own the stock, it's probably too late to climb aboard. The heart is already out of the watermelon.

Look how many institutions thought Citigroup should be a core holding in the late 1990s and 2000s. At one point during the 2008 bank subprime loan and credit crisis, the stock of this leading New York City bank got down to \$3.00 and later \$1.00. Only two years earlier it was \$57. This is why, since its first edition, *How to Make Money in Stocks* has always had two detailed chapters on the subject of when to sell your stock. Most investors have no rules or plan for when to sell. That is a serious mistake. So get realistic.

Another case was American International Group. In 2008, AIG had more than 3,600 institutional owners when it tanked to 50 cents from the over \$100 it had sold for in 2000. The government-sponsored Fannie Mae collapsed to less than a dollar during the same financial fiasco.

America Online in the summer of 2001 and Cisco Systems in the summer of 2000 were also overowned by more than a thousand institutions. This potential heavy supply can adversely affect a stock during bear market periods. Many funds will pile into certain leaders on the way up and pile out on the way down.

An Unassailable Institutional Growth Stock Tops

Some stocks may seem invincible, but the old saying is true: what goes up must eventually come down. No company is forever immune to management problems, economic slowdowns, and changes in market direction. Savvy investors know that in the stock market, there are few “sacred cows.” And there are certainly no guarantees.

In June 1974, few people could believe it when William O’Neil + Co. put Xerox on its institutional avoid or sell list at \$115. Until then, Xerox had been one of the most amazingly successful and widely held institutional stocks, but our data indicated that it had topped and was headed down. It was also overowned. Institutional investors went on to make Xerox their most widely purchased stock for that year. But when the stock tumbled in price, it showed the true condition of the company at that time.

That episode called attention to our institutional services firm and got us our first major insurance company account in New York City. The firm had been buying Xerox in the \$80s on the way down until we persuaded it that it should be selling instead.

We also received a lot of resistance in 1998 when we put Gillette, another sacred cow, on our avoid list near \$60 before it tanked. Enron was removed from our new ideas list on November 29, 2000, at \$72.91, and we stopped following it. (Six months later it was \$45, and six months after that it was below \$5 and headed for bankruptcy.)

A list of some of the technology stocks that were removed from our New Stock Market Ideas (NSMI) institutional service potential new ideas list in 2000, when most analysts were incorrectly calling them buys, appears on page 198. The lesson: don’t be swayed by a stock’s broad-based popularity or an analyst advising investors to buy stocks on the way down in price.

Institutional Sponsorship Means Market Liquidity

Another benefit to you as an individual investor is that institutional sponsorship provides buying support when you want to sell your investment. If there’s no sponsorship, and you try to sell your stock in a poor market, you may have problems finding someone to buy it. Daily marketability is one of the big advantages of owning high-quality stocks in the United States. (Real estate is far less liquid, and sales commissions and fees are much higher.) Good institutional sponsorship provides continuous liquidity for you. In a poor real estate market, there is no guarantee that you can find a willing buyer when you want to sell. It could take you six months to a year, and you could sell for a much lower price than you expected.

Stocks Removed from NSMI Buys in 2000

Symbol	Name	Date Removed	Price Removed	Low Price as of 10/30/01	Percent Decline as of 10/30/01*
AMAT	Applied Materials	5/11/2000	\$80.56	\$26.59	67%
CSCO	Cisco Systems	8/1/2000	\$63.50	\$11.04	83%
CNXT	Conexant Systems	3/3/2000	\$84.75	\$6.57	92%
DELL	Dell Computer Corp	5/9/2000	\$46.31	\$16.01	65%
EMC	E M C Corp	12/15/2000	\$74.63	\$10.01	87%
EXDS	Exodus Communications	3/30/2000	\$69.25	\$0.14	100%
INTC	Intel Corp	9/15/2000	\$58.00	\$18.96	67%
JDSU	J D S Uniphase	10/10/2000	\$90.50	\$5.12	94%
MOT	Motorola	3/30/2000	\$51.67	\$10.50	80%
NXTL	Nextel Communications	4/12/2000	\$55.41	\$6.87	88%
NT	Nortel Networks	10/2/2000	\$59.56	\$4.76	92%
PMCS	P M C Sierra Inc	8/1/2000	\$186.25	\$9.37	95%
QLGC	Qlogic Corp	3/14/2000	\$167.88	\$17.21	90%
SEBL	Siebel Systems Inc	12/15/2000	\$76.88	\$12.24	84%
SUNW	Sun Microsystems	11/9/2000	\$49.32	\$7.52	85%
VIGN	Vignette Corp	3/15/2000	\$88.33	\$3.08	97%
YHOO	Yahoo!	3/30/2000	\$175.25	\$8.02	95%

*Percentages have been rounded to the nearest whole number.

In summary: **buy only those stocks that have at least a few institutional sponsors with better-than-average recent performance records and that have added institutional owners in recent quarters.** If I find that a stock has a large number of sponsors, but that none of the sponsors is on my list of the 10 or so excellent-performing funds, in the majority of cases I will pass over the stock. Institutional sponsorship is one more important tool to use as you analyze a stock for purchase. From your list of most savvy funds, check to see what were the two or three stocks each one put the most dollars into in the most recent quarter. You might get one or two names to research. Just make sure these prospects pass the critical CAN SLIM rules and the chart is in the right position to buy before you act.

M = Market Direction: How You Can Determine It

You can be right on every one of the factors in the last six chapters, but if you're wrong about the direction of the general market, and that direction is down, three out of four of your stocks will plummet along with the market averages, and you will lose money big time, as many people did in 2000 and again in 2008. Therefore, in your analytical tool kit, you absolutely must have a proven, reliable method to accurately determine whether you're in a bull (uptrending) market or a bear (downtrending) market. Very few investors or stockbrokers have such an essential tool. Many investors depend on someone else to help them with their investments. Do these other advisors or helpers have a sound set of rules to determine when the general market is starting to get into trouble?

That's not enough, however. If you're in a bull market, you need to know whether it's in the early stage or a later stage. And more importantly, you need to know what the market is doing right now. Is it weak and acting badly, or is it merely going through a normal intermediate decline (typically 8% to 12%)? Is it doing just what it should be, considering the basic current conditions in the country, or is it acting abnormally strong or weak? To answer these and other vital questions, you'll want to learn to analyze the overall market correctly, and to do that, you must start at the most logical point.

The market direction method we discovered and developed many years ago is such a key element in successful investing you'll want to reread this chapter several times until you understand and can apply it on a day-to-day basis for the rest of your investment life. If you learn to do this well, you

should never in the future find your investment portfolio down 30% to 50% or more in a bad bear market.

The best way for you to determine the direction of the market is to look carefully at, follow, interpret, and understand the daily charts of the three or four major general market averages and what their price and volume changes are doing on a day-to-day basis. This might sound intimidating at first, but with patience and practice, you'll soon be analyzing the market like a true pro. This is the most important lesson you can learn if you want to stop losing and start winning. Are you ready to get smarter? Are your future peace of mind and financial independence worth some extra effort and determination on your part?

Don't ever let anyone tell you that you can't time the market. This is a giant myth passed on mainly by Wall Street, the media, and those who have never been able to do it, so they think it's impossible. We've heard from thousands of readers of this chapter and *Investor's Business Daily's The Big Picture* column who have learned how to do it. They took the time to read the rules and do their homework so that they were prepared and knew exactly what facts to look for. As a result, they had the foresight and understanding to sell stocks and raise cash in March 2000 and from November 2007 to January 2008 and June 2008, protecting much of the gains they made during 1998 and 1999 and in the strong five-year Bush bull market in stocks that lasted from March 2003 to June 2008.

The erroneous belief that you can't time the market—that it's simply impossible, that no one can do it—evolved more than 40 years ago after a few mutual fund managers tried it unsuccessfully. They had to both sell at exactly the right time and then get back into the market at exactly the right time. But because of their asset size problems, and because they had no system, it took a number of weeks for them to believe the turn and finally reenter the market. They relied on their personal judgments and feelings to determine when the market finally hit bottom and turned up for real. At the bottom, the news is all negative. So these managers, being human, hesitated to act. Their funds therefore lost some relative performance during the fast turnarounds that frequently happen at market bottoms.

For this reason, and despite the fact that twice in the 1950s, Jack Dreyfus successfully raised cash in his Dreyfus Fund at the start of a bear market, top management at most mutual funds imposed rigid rules on money managers that required them to remain fully invested (95% to 100% of assets). This possibly fits well with the sound concept that mutual funds are truly long-term investments. Also, because funds are typically widely diversified (owning a hundred or more stocks spread among many industries), in time they will always recover when the market recovers. So owning them for 15

or 20 years has always been extremely rewarding in the past and should continue to be in the future. However, you, as an individual investor owning 5, 10, or 20 stocks, don't have a large size handicap. Some of your stocks can drop substantially and maybe never come back or take years to do so. Learning when it's wise to raise cash is very important for you . . . so study and learn how to successfully use this technique to your advantage.

What Is the General Market?

The *general market* is a term referring to the most commonly used market indexes. These broad indexes tell you the approximate strength or weakness in each day's overall trading activity and can be one of your earliest indications of emerging trends. They include

- *The Standard & Poor's (S&P) 500*. Consisting of 500 companies, this index is a broader, more modern representation of market action than the Dow.
- *The Nasdaq Composite*. This has been a somewhat more volatile and relevant index in recent years. The Nasdaq is home to many of the market's younger, more innovative, and faster-growing companies that trade via the Nasdaq network of market makers. It's a little more weighted toward the technology sector.
- *The Dow Jones Industrial Average (DJIA)*. This index consists of 30 widely traded big-cap stocks. It used to focus primarily on large, cyclical, industrial issues, but it has broadened a little in recent years to include companies such as Coca-Cola and Home Depot. It's a simple but rather out-of-date average to study because it's dominated by large, established, old-line companies that grow more slowly than today's more entrepreneurial concerns. It can also be easily manipulated over short time periods because it's limited to only 30 stocks.
- *The NYSE Composite*. This is a market-value-weighted index of all stocks listed on the New York Stock Exchange.

All these key indexes are shown in *Investor's Business Daily* in large, easy-to-analyze charts that also feature a moving average and an Accumulation/Distribution Rating (ACC/DIS RTG®) for each index. The Accumulation/Distribution Rating tells you if the index has been getting buying support recently or is undergoing significant selling. I always try to check these indexes every day because a key change can occur over just a few weeks, and you don't want to be asleep at the switch and not see it. IBD's "The Big Picture" column also evaluates these indexes daily to materially help you in deciphering the market's current condition and direction.

Why Is Skilled, Careful Market Observation So Important?

A Harvard professor once asked his students to do a special report on fish. His scholars went to the library, read books about fish, and then wrote their expositions. But after turning in their papers, the students were shocked when the professor tore them up and threw them in the wastebasket.

When they asked him what was wrong with the reports, the professor said, “If you want to learn anything about fish, sit in front of a fishbowl and look at fish.” He made his students sit and watch fish for hours. Then they rewrote their assignment solely on their observations of the objects themselves.

Being a student of the market is like being a student in this professor’s class: if you want to learn about the market, you must observe and study the major indexes carefully. In doing so, you’ll come to recognize when the daily market averages are changing at key turning points—such as major market tops and bottoms—and learn to capitalize on this with real knowledge and confidence.

There’s an important lesson here. To be highly accurate in any pursuit, you must observe and analyze the objects themselves carefully. If you want to know about tigers, you need to watch tigers—not the weather, not the vegetation, and not the other animals on the mountain.

Years ago, when Lou Brock set his mind to breaking baseball’s stolen base record, he had all the big-league pitchers photographed with high-speed film from the seats behind first base. Then he studied the film to learn what part of each pitcher’s body moved first when he threw to first base. The pitcher was the object that Brock was trying to beat, so it was the pitchers themselves that he studied in great detail.

In the 2003 Super Bowl, the Tampa Bay Buccaneers were able to intercept five Oakland Raider passes by first studying and then concentrating on the eye movements and body language of Oakland’s quarterback. They “read” where he was going to throw.

Christopher Columbus didn’t accept the conventional wisdom about the earth being flat because he himself had observed ships at sea disappearing over the horizon in a way that told him otherwise. The government uses wiretaps, spy planes, unmanned drones, and satellite photos to observe and analyze objects that could threaten our security. That’s how we discovered Soviet missiles in Cuba.

It’s the same with the stock market. To know which way it’s going, you must observe and analyze the major general market indexes daily. Don’t ever, ever ask anyone: “What do you think the market’s going to do?” Learn to accurately read what the market is actually doing each day as it is doing it.

Recognizing when the market has hit a top or has bottomed out is frequently 50% of the whole complicated investment ball game. It’s also the

key investing skill virtually all investors, whether amateur or professional, seem to lack. In fact, Wall Street analysts completely missed calling the market top in 2000, particularly the tops in every one of the high-technology leaders. They didn't do much better in 2008.

We conducted four surveys of IBD subscribers in 2008 and also received hundreds of letters from subscribers that led us to believe that 60% of IBD readers sold stock and raised cash in either December 2007 or June 2008 with the help of "The Big Picture" column and by applying and acting on our rule about five or six distribution days over any four- or five-week period. They preserved their capital and avoided the brunt of the dramatic and costly market collapse in the fall of 2008 that resulted from excessive problems in the market for subprime mortgage real estate loans (which had been sponsored and strongly encouraged by the government). You may have seen some of our subscribers' comments in IBD at the top of a page space titled "You Can Do It Too." You'll learn exactly how to apply IBD's general market distribution rules later in this chapter.

The Stages of a Stock Market Cycle

The winning investor should understand how a normal business cycle unfolds and over what period of time. The investor should pay particular attention to recent cycles. There's no guarantee that just because cycles lasted three or four years in the past, they'll last that long in the future.

Bull and bear markets don't end easily. It usually takes two or three tricky pullbacks up or down to fake out or shake out the few remaining speculators. After everyone who can be run in or run out has thrown in the towel, there isn't anyone left to take action in the same market direction. Then the market will finally turn and begin a whole new trend. Most of this is crowd psychology constantly at work.

Bear markets usually end while business is still in a downtrend. The reason is that stocks are anticipating, or "discounting," all economic, political, and worldwide events many months in advance. The stock market is a *leading* economic indicator, not a *coincident* or *lagging* indicator, in our government's series of key economic indicators. The market is exceptionally perceptive, taking all events and basic conditions into account. It will react to what is taking place and what it can mean for the nation. The market is not controlled by Wall Street. Its action is determined by lots of investors all across the country and thousands of large institutions and is a consensus conclusion on whether it likes or doesn't like what it foresees—such as what our government is doing or about to do and what the consequences could be.

Similarly, bull markets usually top out and turn down before a recession sets in. For this reason, looking at economic indicators is a poor way to determine when to buy or sell stocks and is not recommended. Yet, some investment firms do this very thing.

The predictions of many economists also leave a lot to be desired. A few of our nation's presidents have had to learn this lesson the hard way. In early 1983, for example, just as the economy was in its first few months of recovery, the head of President Reagan's Council of Economic Advisers was concerned that the capital goods sector was not very strong. This was the first hint that this advisor might not be as sound as he should be. Had he understood historical trends, he would have seen that capital goods demand has never been strong in the early stage of a recovery. This was especially true in the first quarter of 1983, when U.S. plants were operating at a low percentage of capacity.

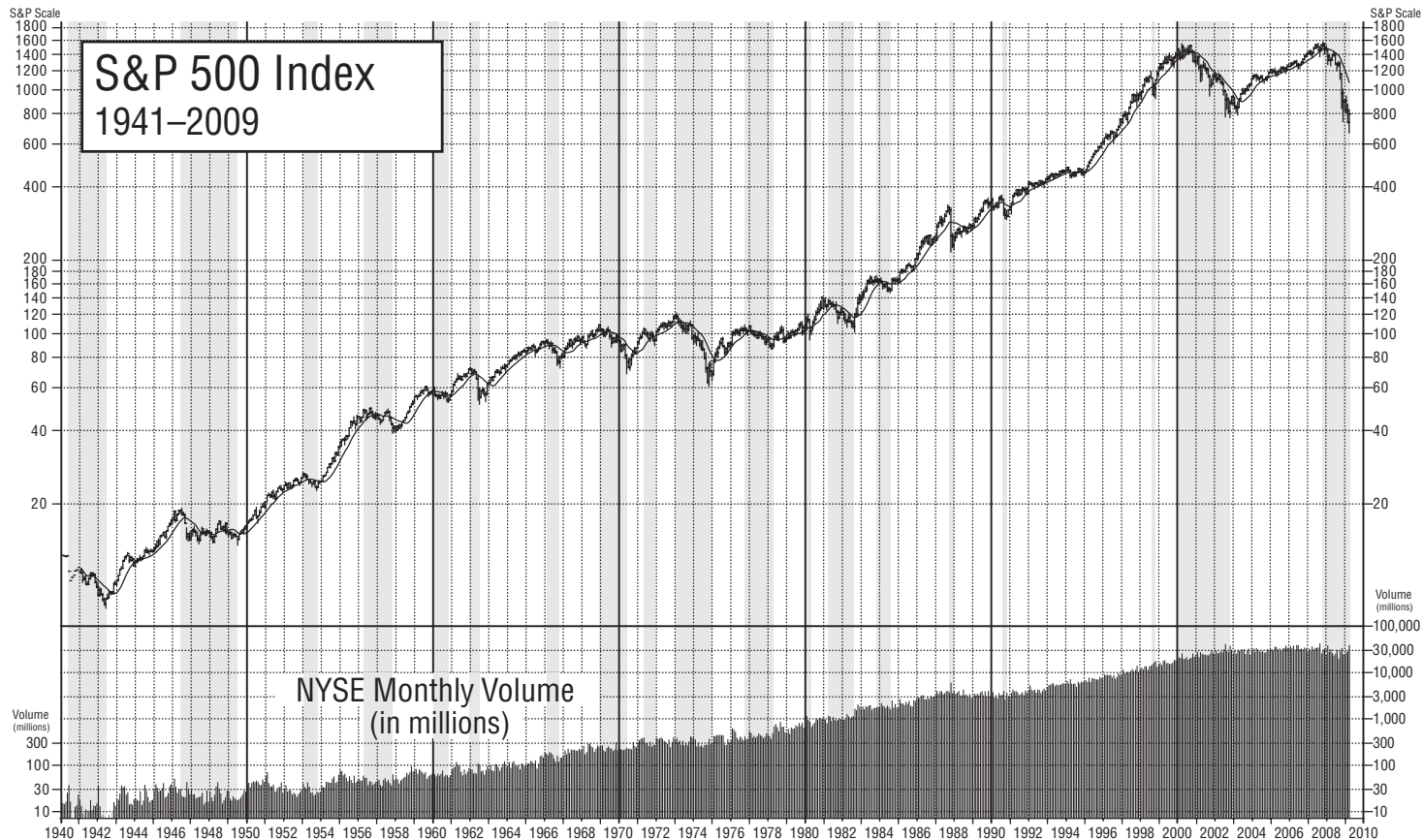
You should check earlier cycles to learn the sequence of industry-group moves at various stages of the market cycle. If you do, you'll see that railroad equipment, machinery, and other capital goods industries are late movers in a business or stock market cycle. This knowledge can help you get a fix on where you are now. When these groups start running up, you know you're near the end. In early 2000, computer companies supplying Internet capital goods and infrastructure were the last-stage movers, along with telecommunications equipment suppliers.

Dedicated students of the market who want to learn more about cycles and the longer-term history of U.S. economic growth may want to write to Securities Research Company, 27 Wareham Street, #401, Boston, MA 02118, and purchase one of the company's long-term wall charts. Also, in 2008, Daily Graphs, Inc., created a 1900 to 2008 stock market wall chart that shows major market and economic events.

Some charts of market averages also include major news events over the last 12 months. These can be very valuable, especially if you keep and review back copies. You then have a history of both the market averages and the events that have influenced their direction. It helps to know, for example, how the market has reacted to new faces in the White House, rumors of war, controls on wages and prices, changes in discount rates, or just loss of confidence and "panics" in general. The accompanying chart of the S&P 500 Index shows several past cycles with the bear markets shaded.

You Should Study the General Market Indexes Each Day

In bear markets, stocks usually open strong and close weak. In bull markets, they tend to open weak and close strong. The general market averages need to be checked every day, since reverses in trends can begin on any



given few days. Relying on these primary indexes is a more direct, practical, and effective method for analyzing the market's behavior and determining its direction.

Don't rely on other, subsidiary indicators because they haven't been proven to be effective at timing. Listening to the many market newsletter writers, technical analysts, or strategists who pore over 30 to 50 different technical or economic indicators and then tell you what they think the market should be doing is generally a very costly waste of time. Investment newsletters can create doubt and confusion in an investor's mind. Interestingly enough, history shows that the market tends to go up just when the news is all bad and these experts are most skeptical and uncertain.

When the general market tops, you must sell to raise at least some cash and to get off margin (the use of borrowed money) to protect your account. As an individual investor, you can easily raise cash and get out in one or two days, and you can likewise reenter later when the market is finally right. If you don't sell and raise cash when the general market tops, your diversified list of former market leaders can decline sharply. Several of them may never recover to their former levels.

Your best bet is to learn to interpret daily price and volume charts of the key general market averages. If you do, you can't get too far off-track, and you won't need much else. It doesn't pay to argue with the market. Experience teaches that second-guessing the market can be a very expensive mistake.

The Prolonged Two-Year Bear Market of 1973–1974

The combination of the Watergate scandal and hearings and the 1974 oil embargo by OPEC made 1973–1974 the worst stock market catastrophe up to that time since the 1929–1933 depression. The Dow corrected 50%, but the average stock plummeted more than 70%.

This was a big lesson for stockholders and was almost as severe as the 90% correction the average stock showed from 1929 to 1933. However, in 1933, industrial production was only 56% of the 1929 level, and more than 13 million Americans were unemployed. The peak unemployment rate in the 1930s was 25%. It remained in double digits throughout the entire decade and was 20% in 1939.

The markets were so demoralized in the prolonged 1973–1974 bear market that most members on the floor of the New York Stock Exchange were afraid the exchange might not survive as a viable institution. This is why it's absolutely critical that you study the market averages and learn how to protect yourself against catastrophic losses, for the sake of your health as well as your portfolio.

A 33% Drop Requires a 50% Rise to Break Even

The critical importance of knowing the change in direction of the general market cannot be overemphasized. If you have a 33% loss in a stock portfolio, you need a 50% gain just to get back to breakeven. If, for example, you let a \$10,000 portfolio drop to \$6,666 (a 33% decline), it has to rise \$3,333 (or 50%) just to get you back where you started. In the 2007–2009 bear market, the S&P 500 fell 58%, meaning that a 140% rebound will be needed for the index to fully recover. And how easy is it for you to make 140%? Maybe it's time for you to learn what you're doing, adopt new selling rules and methods, and stop doing the things that create 50% losses.

You positively must always act to preserve as much as possible of the profit you've built up during a bull market rather than ride your investments back down through difficult bear market periods. To do this, you must learn historically proven stock and general market selling rules. (See Chapters 10 and 11 for more on selling rules.)

The Myths about “Long-Term Investing” and Being Fully Invested

Many investors like to think of, or at least describe, themselves as “long-term investors.” Their strategy is to stay fully invested through thick and thin. Most institutions do the same thing. But such an inflexible approach can have tragic results, particularly for individual investors. Individuals and institutions alike may get away with standing pat through relatively mild (25% or less) bear markets, but many bear markets are not mild. Some, such as 1973–1974, 2000–2002, and 2007–2008, are downright devastating.

The challenge always comes at the beginning, when you start to sense an impending bear market. In most cases, you cannot project how bad economic conditions might become or how long those bad conditions could linger. The war in Vietnam, inflation, and a tight money supply helped turn the 1969–1970 correction into a two-year decline of 36.9%. Before that, bear markets averaged only nine months and took the averages down 26%.

Most stocks fall during a bear market, but not all of them recover. If you hold on during even a modest bear correction, you can get stuck with damaged merchandise that may never see its former highs. You definitely must learn to sell and raise at least some cash when the overall environment changes and your stocks are not working.

Buy-and-hold investors fell in love with Coca-Cola during the 1980s and 1990s. The soft-drink giant chugged higher year after year, rising and falling with the market. But it stopped working in 1998, as did Gillette, another favorite of long-term holders. When the market slipped into its mild bear

correction that summer, Coke followed along. Two years later—after some of the market's most exciting gains in decades—Coke was still stuck in a downtrend. In some instances, stocks of this kind may come back. But this much is certain: Coke investors missed huge advances in 1998 and 1999 in names such as America Online and Qualcomm.

The buy-and-hold strategy was also disastrous to anyone who held technology stocks from 2000 through 2002. Many highfliers lost 75% to 90% of their value, and some may never return to their prior highs. Take a look now at Time Warner, Corning, Yahoo!, Intel, JDS Uniphase, and EMC, former market leaders in 1998–2000.

Protecting Yourself from Market Downturns

Napoleon once wrote that never hesitating in battle gave him an advantage over his opponents, and for many years he was undefeated. In the battlefield that is the stock market, there are the quick and there are the dead!

After you see the first several definite indications of a market top, don't wait around. Sell quickly before real weakness develops. When market indexes peak and begin major downside reversals, you should act immediately by putting 25% or more of your portfolio in cash, selling your stocks at market prices. The use of limit orders (buying or selling at a specific price, rather than buying or selling at market prices using market orders) is not recommended. Focus on your ability to get into or out of a stock when you need to. Quibbling over an eighth- or quarter-point (or their decimal equivalents) could make you miss an opportunity to buy or sell a stock.

Lightning-fast action is even more critical if your stock account is on margin. If your portfolio is fully margined, with half of the money in your stocks borrowed from your broker, a 20% decline in the price of your stocks will cause you to lose 40% of your money. A 50% decline in your stocks could wipe you out! Never, ever try to ride through a bear market on margin.

In the final analysis, there are really only two things you can do when a new bear market begins: sell and retreat or go short. When you retreat, you should stay out until the bear market is over. This usually means five or six months or more. In the prolonged, problem-ridden 1969–1970 and 1973–1974 periods, however, it meant up to two years. The bear market that began in March 2000 during the last year of the Clinton administration lasted longer and was far more severe than normal. Nine out of ten investors lost a lot of money, particularly in high-tech stocks. It was the end of a period of many excesses during the late 1990s, a decade when America got careless and let down its guard. It was the “anything goes” period, with stocks running wild.

Selling short can be profitable, but be forewarned: it's a very difficult and highly specialized skill that should be attempted only during bear markets. Few people make money at it. Short selling is discussed in more detail in Chapter 12.

Using Stop-Loss Orders

If you use stop-loss orders or mentally record a selling price and act upon it, a market that is starting to top out will mechanically force you, robotlike, out of many of your stocks. A stop-loss order instructs the specialist in the stock on the exchange floor that once the stock has dropped to your specified price, the order becomes a market order, and the stock will be sold out on the next transaction.

It's usually better not to enter stop-loss orders. In doing so, you and other similarly minded investors are showing your hand to market makers, and at times they might drop the stock to shake out stop-loss orders. Instead, watch your stocks closely and know ahead of time the exact price at which you will immediately sell to cut a loss. However, some people travel a lot and aren't able to watch their stocks closely, and others have a hard time making sell decisions and getting out when they are losing. In such cases, stop-loss orders help compensate for distance and indecisiveness.

If you use a stop-loss order, remember to cancel it if you change your mind and sell a stock before the order is executed. Otherwise, you could later accidentally sell a stock that you no longer own. Such errors can be costly.

How You Can Learn to Identify Stock Market Tops

To detect a market top, keep a close eye on the daily S&P 500, NYSE Composite, Dow 30, and Nasdaq Composite as they work their way higher. On one of the days in the uptrend, volume for the market as a whole will increase from the day before, but the index itself will show stalling action (a significantly smaller price increase for the day compared with the prior day's much larger price increase). I call this "heavy volume without further price progress up." The average doesn't have to close down for the day, but in most instances it will, making the distribution (selling) much easier to see, as professional investors liquidate stock. The spread from the average's daily high to its daily low may in some cases be a little wider than on previous days.

Normal liquidation near the market peak will usually occur on three to six specific days over a period of four or five weeks. In other words, the market comes under distribution while it's advancing! This is one reason so few people know how to recognize distribution. After four or five days of definite

distribution over any span of four or five weeks, the general market will almost always turn down.

Four days of distribution, if correctly spotted over a two- or three-week period, are sometimes enough to turn a previously advancing market into a decline. Sometimes distribution can be spread over six weeks if the market attempts at some point to rally back to new highs. If you are asleep or unaware and you miss the topping signals given off by the S&P 500, the NYSE Composite, the Nasdaq, or the Dow (which is easy to do, since they sometimes occur on only a few days), you could be wrong about the market direction and therefore wrong on almost everything you do.

One of the biggest problems is the time it takes to reverse investors' positive personal opinions and views. If you always sell and cut your losses 7% or 8% below your buy points, you may automatically be forced to sell at least one or two stocks as a correction in the general market starts to develop. This should get you into a questioning, defensive frame of mind sooner. Following this one simple but powerful rule of ours saved a lot of people big money in 2000's devastating decline in technology leaders and in the 2008 subprime loan bear market.

It takes only one of the indexes to give you a valid repeated signal of too much distribution. You don't normally need to see several of the major indexes showing four, five, or six distribution days. Also, if one of the indexes is down for the day on volume larger than the prior day's volume, it should decline more than 0.2% for this to be counted as a distribution day.

After the Initial Decline Off the Top, Track Each Rally Attempt on the Way Down

After the required number of days of increased volume distribution around the top and the first decline resulting from this, there will be either a poor rally in the market averages, followed by a rally failure, or a positive and powerful follow-through day up on price and volume. You should learn in detail exactly what signals to look for and remain unbiased about the market. Let the day-by-day averages tell you what the market has been doing and is doing. (See "How You Can Spot Stock Market Bottoms" later in this chapter for a further discussion of market rallies.)

Three Signs the First Rally Attempt May Fail

After the market does top out, it typically will rally feebly and then fail. After the first day's rebound, for instance, the second day will open strongly but suddenly turn down near the end of the session. The abrupt failure of the

market to follow through on its first recovery attempt should probably be met with further selling on your part.

You'll know that the initial bounce back is feeble if (1) the index advances in price on the third, fourth, or fifth rally day, but on volume that is lower than that of the day before, (2) the average makes little net upward price progress compared with its progress the day before, or (3) the market average recovers less than half of the initial drop from its former absolute intraday high. When you see these weak rallies and failures, further selling is advisable.

How CAN SLIM and IBD Red-Flagged the March 2000 Nasdaq Top

In October 1999, the market took off on a furious advance. Fears of a Y2K meltdown on January 1, 2000, had faded. Companies were announcing strong profits for the third quarter just ended. Both leading tech stocks and speculative Internet and biotechnology issues racked up huge gains in just five months. But cracks started to appear in early March 2000.

On March 7, the Nasdaq closed lower on higher volume, the first time it had done so in more than six weeks. That's unusual action during a roaring bull market, but one day of distribution isn't significant on its own. Still, it was the first yellow flag and was worth watching carefully.

Three days later, the Nasdaq bolted up more than 85 points to a new high in the morning. But it reversed in the afternoon and finished the day up only 2 points on heavy volume that was 13% above average. This was the second warning sign. That churning action (a lot of trading but no real price progress—a clear sign of distribution) was all the more important because leading stocks started showing their own symptoms of hitting climax tops—action that will be discussed in Chapter 11. Just two days later, on March 14, the market closed down 4% on a large volume increase. This was the third major warning signal of distribution and one where you should have been taking some selling action.

The index managed to put together a suspect rally from March 16 to 24, then stalled again for a fourth distribution day. It soon ran out of steam and rolled over on heavier volume two days later for a fifth distribution day and a final, definite confirmation of the March 10 top. The market itself was telling you to sell, raise cash, and get out of your stocks. All you had to do was read it right and react, instead of listening to your or other people's opinions. Other people are too frequently wrong and are probably clueless about recognizing or understanding distribution days.

During the next two weeks, the Nasdaq, along with the S&P 500 and the Dow, suffered repeated bouts of distribution as the indexes sold off on heav-

ier volume than on the prior day. Astute CAN SLIM investors who had read, studied, and prepared themselves by knowing exactly what to watch for had long since taken their profits.

Study our chart examples of this and other market tops. History repeats itself when it comes to the stock market; you'll see this type of action again and again in the future. So get with it.

Spotting the 2007 Top in the Market

As mentioned earlier, several surveys showed that approximately 60% of IBD subscribers sold stock in 2008 before the rapid stock market break occurred. IBD's "The Big Picture" column clearly pointed out in its special Market Pulse box when the market indexes had five distribution days and the outlook had switched to "Market in correction," and then the column suggested that it was time to raise cash. I'm sure most of those people had read and studied this chapter, including our description of how we retreated from the market in March 2000. They were finally able to use and apply IBD's general market rules to preserve their gains and not have to undergo the severe declines that can occur when you have no protective rules or methods. And hopefully, those who didn't follow the rules will be able to better apply them in the future.

Not much happens by accident in the market. It takes effort on your part to learn what you must know in order to spot each market top. Here's what Apple CEO Steve Jobs said about effort: "The things I've done in my life have required a lot of years of work before they took off." Annotated market topping charts for the period from the 1976 top to the 2007 top start on page 214. Study them . . . if you want to survive and win.

Historical Tops for Further Study

Historically, intermediate-term distribution tops (those that are usually followed by 8% to 12% declines in the general market averages) occur as they did during the first week of August 1954. First, there was increased New York Stock Exchange volume without further upward price progress on the Dow Jones Industrials. That was followed the next day by heavy volume without further price progress up and with a wide price spread from high to low on the Dow. Another such top occurred in the first week of July 1955. It was characterized by a price climax with a wide price spread from the day's low to its high, followed the next day by increased volume with the Dow closing down in price, and then, three days later, increased NYSE volume with the Dow again closing down.

Other bear market and intermediate-term tops for study include

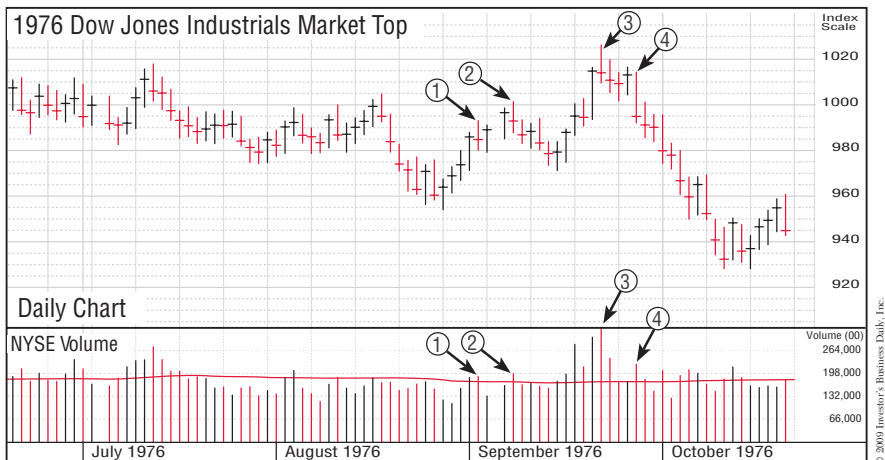
September 1955	June 1966	August 1987
November 1955	May 1967	October 1987
April 1956	September 1967	October 1989
August 1956	December 1967	January 1990
January 1957	December 1968	July 1990
July 1957	May 1969	June 1992
November 1958	April 1971	February 1994
January 1959	September 1971	September 1994
May 1959	January 1973	May 1996
June 1959	October 1973	March 1997
July 1959	July 1975	October 1997
January 1960	September 1976	July 1998
June 1960	September 1978	August 1999
April 1961	September 1979	January 2000
May 1961	February 1980	April 2000
September 1961	November 1980	September 2000
November 1961	April 1981	February 2001
December 1961	June 1981	May 2001
March 1962	December 1981	December 2001
June 1963	May 1982	January 2004
October 1963	January 1984	April 2006
May 1965	July 1986	November 2007
February 1966	September 1986	June 2008
April 1966	April 1987	

If you study the following daily market average graphs of several tops closely and understand how they came about, you'll come to recognize the same indications as you observe future market environments. Each numbered day on these charts is a distribution day.

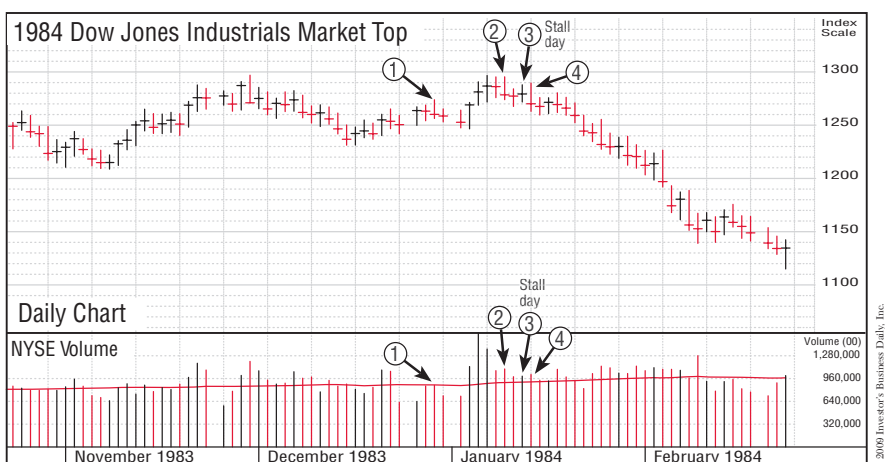
Follow the Leaders for Clues to a Market Top

The second most important indicator of a primary change in market direction, after the daily averages, is the way leading stocks act. After the market has advanced for a couple of years, you can be fairly sure that it's headed for trouble if most of the individual stock leaders start acting abnormally.

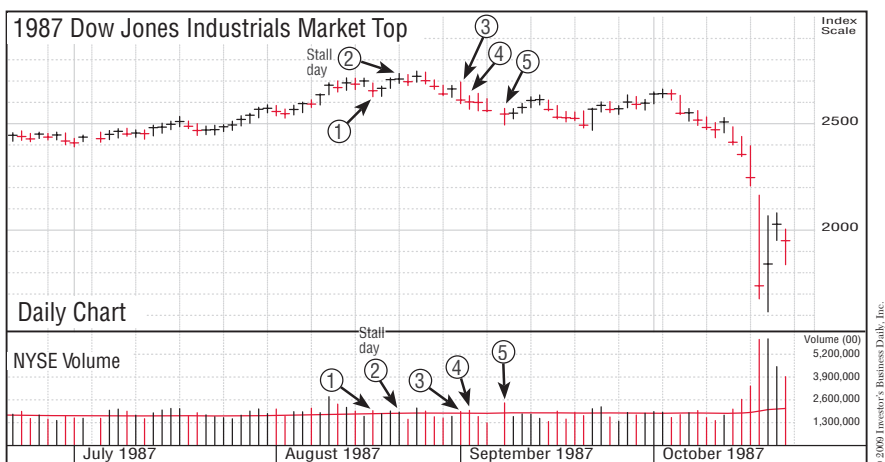
One example of abnormal activity can be seen when leading stocks break out of third- or fourth-stage chart base formations on the way up. Most of these base structures will be faulty, with price fluctuations appearing much



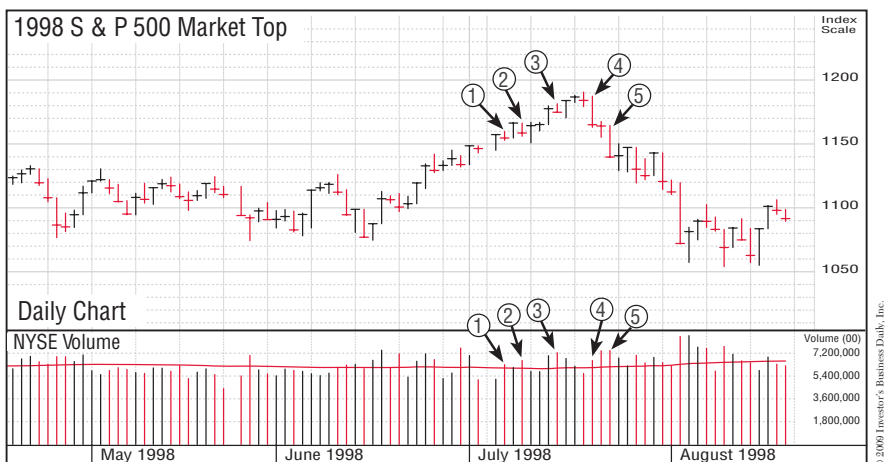
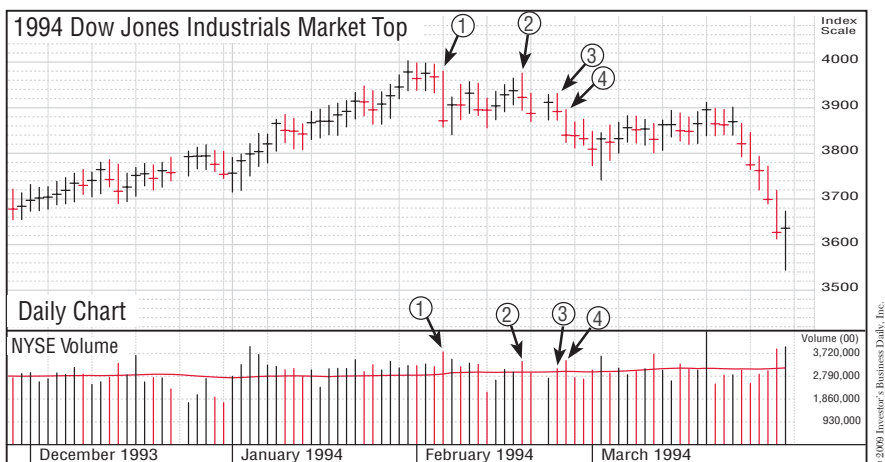
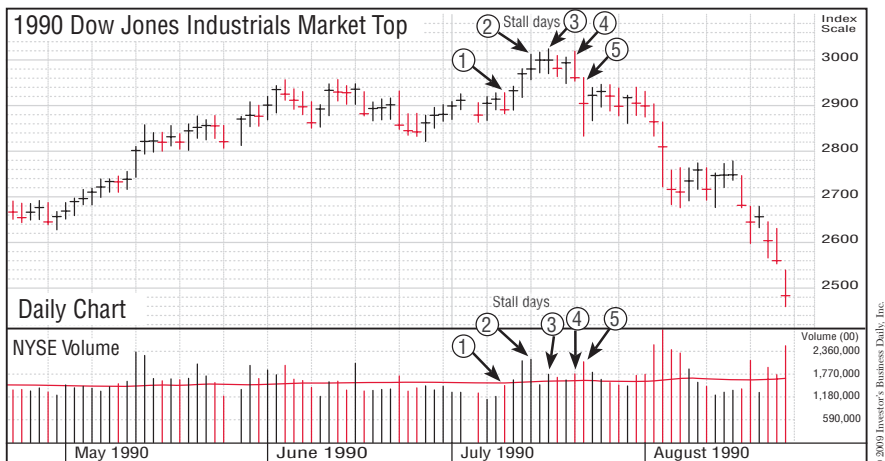
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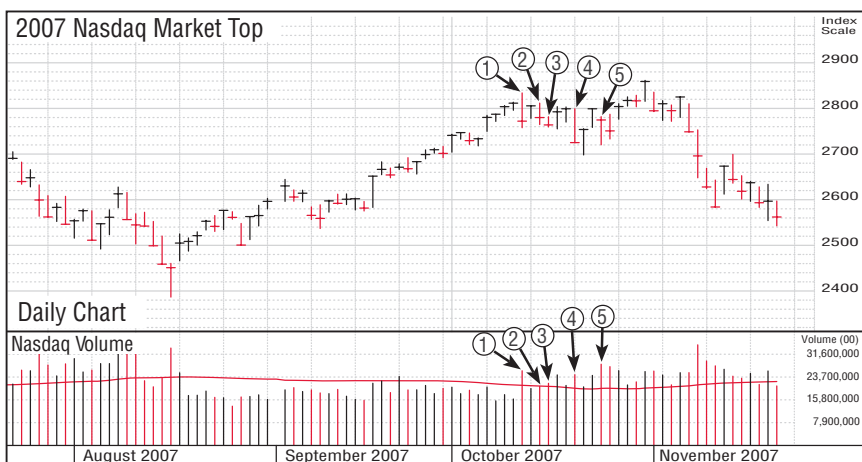
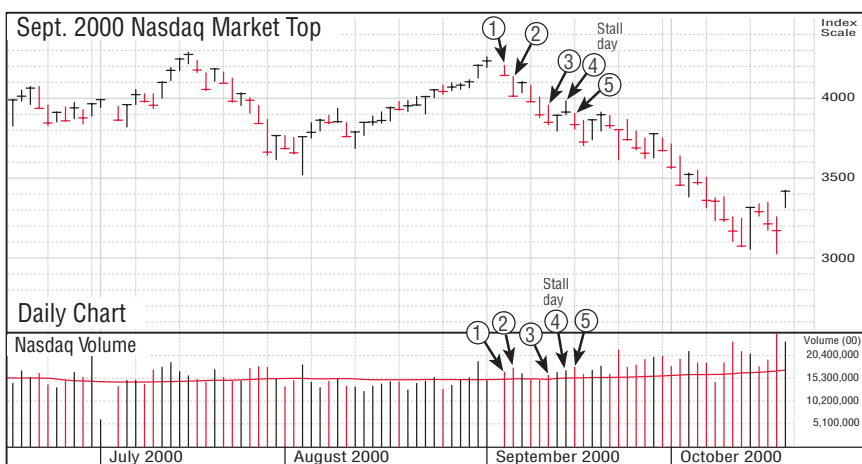
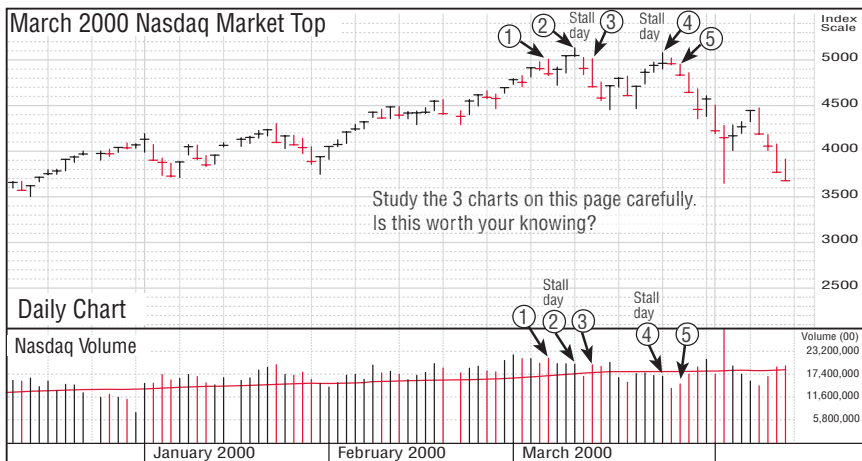


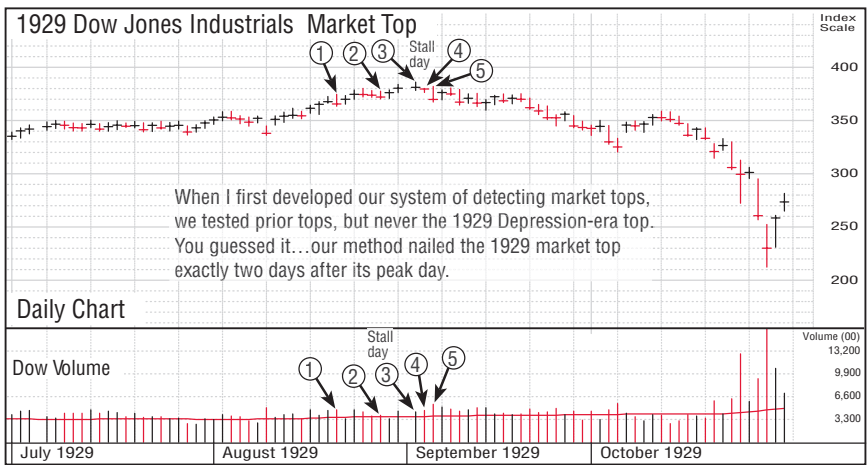
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wider and looser. A faulty base (wide, loose, and erratic) can best be recognized and analyzed by studying charts of a stock's daily or weekly price and volume history.

Another sign of abnormal activity is the “climax” top. Here, a leading stock will run up more rapidly for two or three weeks in a row, after having advanced for many months. (See Chapter 11 on selling.)

A few leaders will have their first abnormal price break off the top on heavy volume but then be unable to rally more than a small amount from the lows of their correction. Still others will show a serious loss of upward momentum in their most recent quarterly earnings reports.

Shifts in market direction can also be detected by reviewing the last four or five stock purchases in your own portfolio. If you haven't made a dime on any of them, you could be picking up signs of a new downtrend.

Investors who use charts and understand market action know and understand that very few leading stocks are attractive around market tops. There simply aren't any stocks coming out of sound, properly formed chart bases. The best merchandise has been bought, played, and well picked over.

Most bases will be wide and loose—a big sign of real danger that you must learn to understand and obey. All that's left to show strength at this stage are laggard stocks. The sight of sluggish or low-priced, lower-quality laggards strengthening is a signal to the wise market operator the up market may be near its end. Even turkeys can try to fly in a windstorm.

During the early phase of a bear market, certain leading stocks will seem to be bucking the trend by holding up in price, creating the impression of strength, but what you're seeing is just a postponement of the inevitable. When they raid the house, they usually get everyone, and eventually all the

leaders will succumb to the selling. This is exactly what happened in the 2000 bear market. Cisco and other high-tech leaders all eventually collapsed in spite of the many analysts who incorrectly said that they should be bought.

That's also what happened at the top of the Nasdaq in June and July of 2008. The steels, fertilizers, and oils that had led the 2003–2007 bull market all rolled over and finally broke down after they appeared to be bucking the overall market top that actually began with at least five distribution days in October of 2007. U.S. Steel tanked even though its next two quarterly earnings reports were up over 100%. Potash topped when its current quarter was up 181% and its next quarter was up 220%. This fooled most analysts, who were focused on the big earnings that had been reported or were expected. They had not studied all past historical tops and didn't realize that many past leaders had topped when earnings were up 100%. Why did these stocks finally cave in? They were in a bear market that had begun eight months earlier, in late 2007.

Market tops, whether intermediate (8% to 12% declines) or primary bull market peaks, sometimes occur five, six, or seven months after the last major buy point in leading stocks and in the averages. Thus, top reversals (when the market closes at the bottom of its trading range after making a new high that day) are usually late signals—the last straw before a cave-in. In most cases, distribution, or selling, has been going on for days or even weeks in individual market leaders. Use of individual stock selling rules, which we'll discuss in Chapters 10 and 11, should already have led you to sell one or two of your holdings on the way up, just before the market peak.

Other Bear Market Warnings

If the original market leaders begin to falter, and lower-priced, lower-quality, more-speculative stocks begin to move up, watch out! When the old dogs begin to bark, the market is on its last feeble leg. Laggards can't lead the market higher. Among the telltale signs are the poor-quality stocks that start to dominate the most-active list on market "up" days. This is simply a matter of weak leadership trying to command the market. If the best ones can't lead, the worst certainly aren't going to do so for very long.

Many top reversals have occurred between the third and the ninth day of a rally after the averages moved into new high ground off short chart bases (meaning that the time span from the start to the end of the pattern was really too short). It's important to note that the conditions under which the tops occurred were all about the same.

At other times, a topping market will recover for a couple of months and get back nearly to its old high or even above it before breaking down in

earnest. This occurred in December 1976, January 1981, and January 1984. There's an important psychological reason for this: the majority of people in the market can't be exactly right at exactly the right time. In 1994, the Nasdaq didn't top until weeks after the Dow did. A similar thing happened in early 2000.

The majority of people in the stock market, including both professional and individual investors, will be fooled first. It's all about human psychology and emotions. If you were smart enough to sell or sell short in January 1981, the powerful rebound in February and March probably forced you to cover your short sales at a loss or buy some stocks back during the strong rally. It was an example of how treacherous the market really can be at turning points.

Don't Jump Back In Too Early

I didn't have much problem recognizing and acting upon the early signs of the many bear markets from 1962 through 2008. But a few times I made the mistake of buying back too early. When you make a mistake in the stock market, the only sound thing to do is to correct it. Don't fight it. Pride and ego never pay off; neither does vacillation when losses start to show up.

The typical bear market (and some aren't typical) usually has three separate phases, or legs, of decline interrupted by a couple of rallies that last just long enough to convince investors to begin buying. In 1969 and 1974, a few of these phony, drawn-out rallies lasted up to 15 weeks. Most don't last that long.

Many institutional investors love to "bottom fish." They'll start buying stocks off a supposed bottom and help make the rally convincing enough to draw you in. You're better off staying on the sidelines in cash until a new bull market really starts.

How You Can Spot Stock Market Bottoms

Once you've recognized a bear market and have scaled back your stock holdings, the big question is how long you should remain on the sidelines. If you plunge back into the market too soon, the apparent rally may fade, and you'll lose money. But if you hesitate at the brink of the eventual roaring recovery, opportunities will pass you by. Again, the daily general market averages provide the best answer by far. Markets are always more reliable than most investors' emotions or personal opinions.

At some point in every correction—whether that correction is mild or severe—the stock market will always attempt to rally. Don't jump back in right away. Wait for the market itself to confirm the new uptrend.

A rally attempt begins when a major market average closes higher after a decline that happened either earlier in the day or during the previous session. For example, the Dow plummets 3% in the morning but then recovers later in the day and closes higher. Or the Dow closes down 2% and then rebounds the next day. We typically call the session in which the Dow finally closes higher the first day of the attempted rally, although there have been some exceptions. For example, the first day of the early October market bottom in 1998 was actually down on heavy volume, but it closed in the upper half of that day's price range. Sit tight and be patient. The first few days of improvement can't tell you whether the rally will succeed.

Starting on the fourth day of the attempted rally, look for one of the major averages to "follow through" with a booming gain on heavier volume than the day before. This tells you the rally is far more likely to be real. The most powerful follow-throughs usually occur on the fourth to seventh days of the rally. The 1998 bottom just mentioned followed through on the sixth day of the attempted rally. The market was up 2.1%. A follow-through day should give the feeling of an explosive rally that is strong, decisive, and conclusive—not begrudging and on the fence or barely up 1½%. The market's volume for the day should in most cases be above its average daily volume, in addition to always being higher than the prior day's trading.

Occasionally, but rarely, a follow-through occurs as early as the third day of the rally. In such a case, the first, second, and third days must all be very powerful, with a major average up 1½% to 2% or more each session in heavy volume.

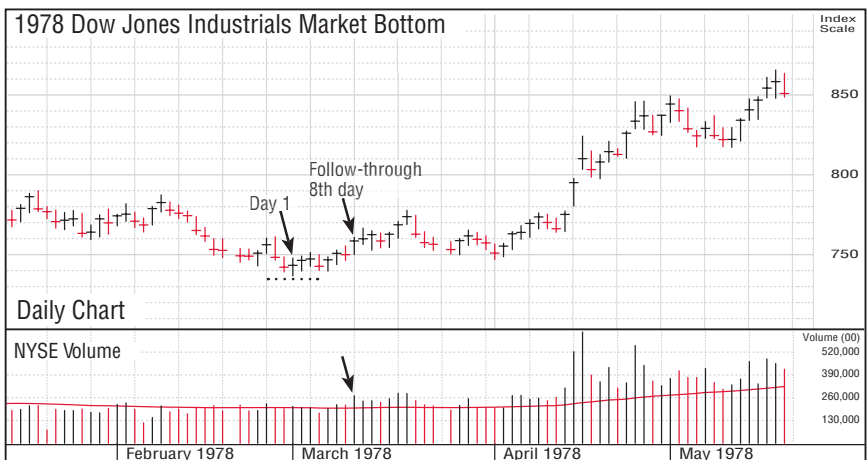
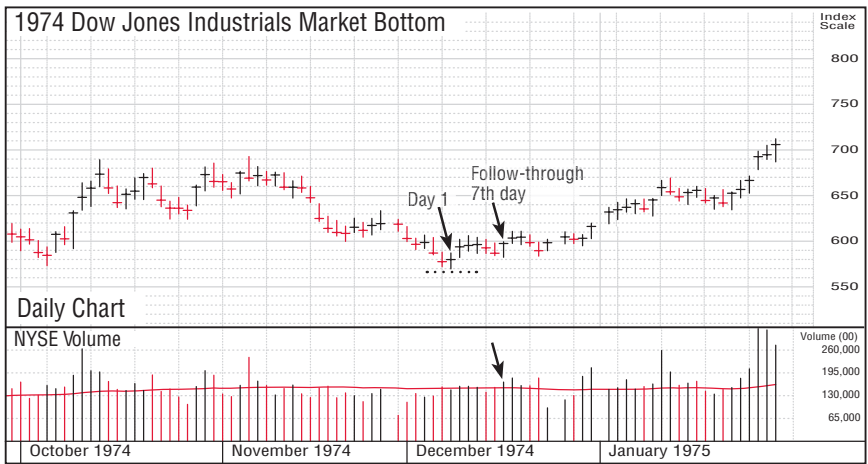
I used to consider 1% to be the percentage increase for a valid follow-through day. However, in recent years, as institutional investors have learned of our system, we've moved the requirement up a significant amount for the Nasdaq and the Dow. By doing this, we are trying to minimize the possibility that professionals will manipulate a few of the 30 stocks in the Dow Jones average to create false or faulty follow-through days.

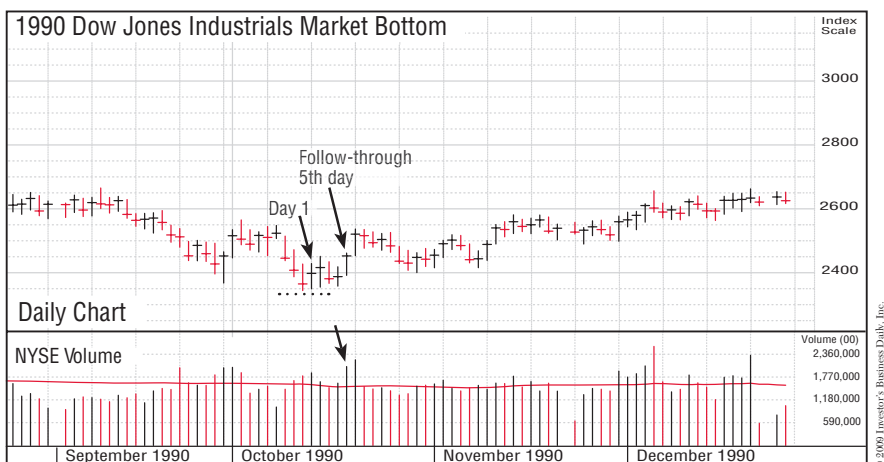
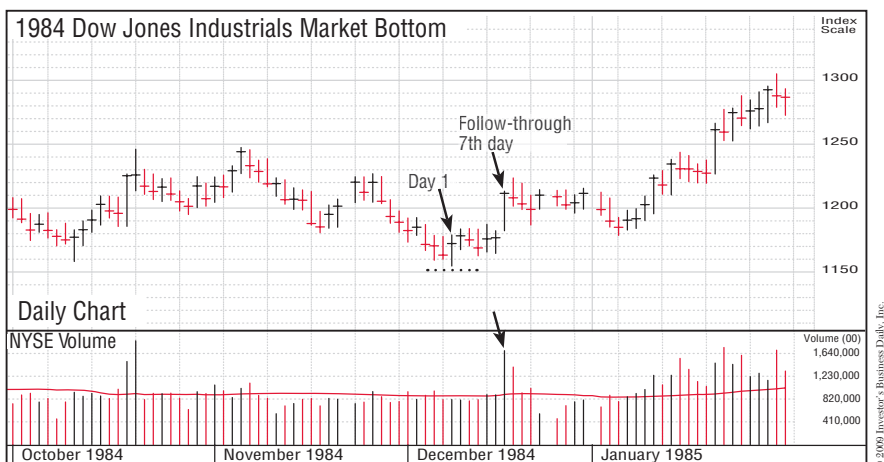
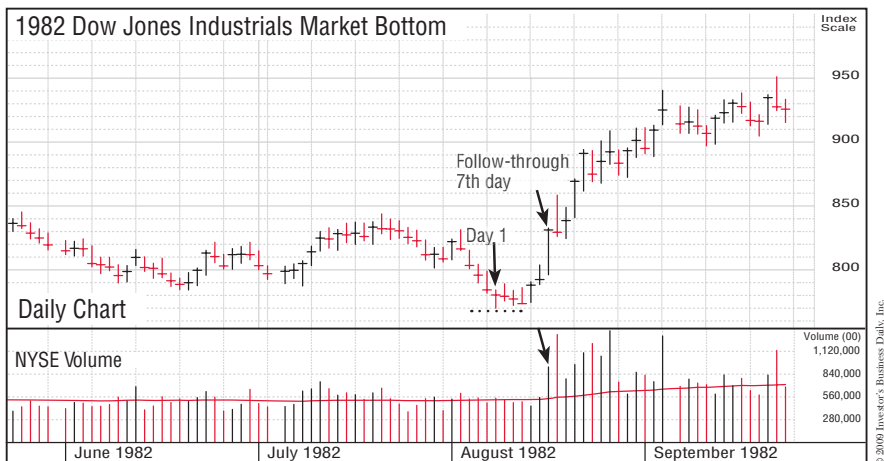
There will be cases in which confirmed rallies fail. A few large institutional investors, armed with their immense buying power, can run up the averages on a particular day and create the impression of a follow-through. Unless the smart buyers are getting back on board, however, the rally will implode—sometimes crashing on heavy volume within the next several days.

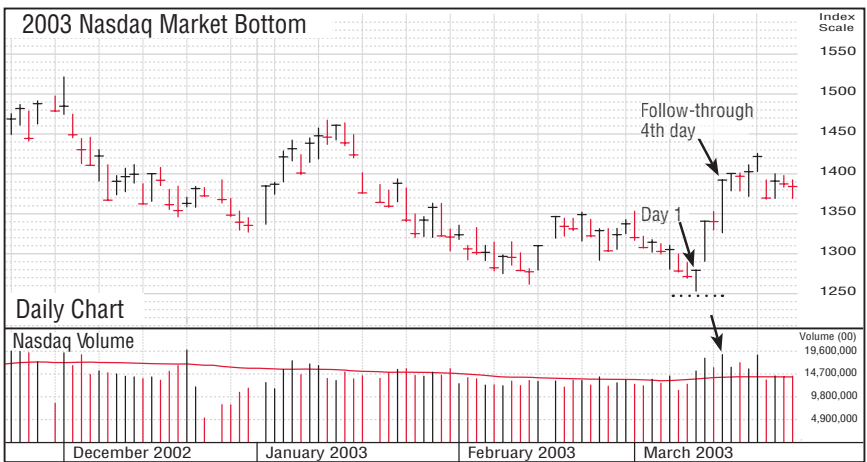
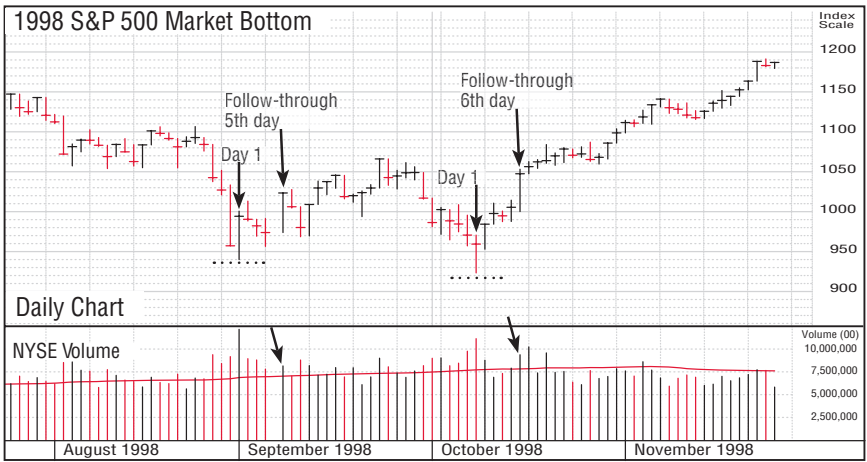
However, just because the market corrects the day after a follow-through doesn't mean the follow-through was false. When a bear market bottoms, it frequently pulls back and settles above or near the lows made during the previous few weeks. It is more constructive when these pullbacks or "tests" hold at least a little above the absolute intraday lows made recently in the market averages.

A follow-through signal doesn't mean you should rush out and buy with abandon. It just gives you the go-ahead to begin buying high-quality stocks with strong sales and earnings as they break out of sound price bases, and it is a vital second confirmation the attempted rally is succeeding.

Remember, no new bull market has ever started without a strong price and volume follow-through confirmation. It pays to wait and listen to the market and act on what it tells you. The following graphs are examples of seven bottoms in the stock market between 1974 and 2003.







The Big Money Is Made in the First Two Years

The really big money is usually made in the first one or two years of a normal new bull market cycle. It is during this period that you must always recognize, and fully capitalize upon, the golden opportunities presented.

The rest of the “up” cycle usually consists of back-and-forth movement in the market averages, followed by a bear market. The year 1965 was one of the few exceptions, but that strong market in the third year of a new cycle was caused by the beginning of the Vietnam War.

In the first or second year of a new bull market, there should be a few intermediate-term declines in the market averages. These usually last a couple of months, with the market indexes dropping by from 8% to an occa-

sional 12% or 15%. After several sharp downward adjustments of this nature, and after at least two years of a bull market have passed, heavy volume without further upside progress in the daily market averages could indicate the early beginning of the next bear market.

Since the market is governed by supply and demand, you can interpret a chart of the general market averages about the same way you read the chart of an individual stock. The Dow Jones Industrial Average and the S&P 500 are usually displayed in the better publications. *Investor's Business Daily* displays the Nasdaq Composite, the New York Stock Exchange Composite, and the S&P 500, with large-size daily price and volume charts stacked one on top of the other for ease of comparing the three. These charts should show the high, low, and close of the market averages day by day for at least six months, together with the daily NYSE and Nasdaq volume in millions of shares traded.

Incidentally, when I began in the market about 50 years ago, an average day on the New York Stock Exchange was 3.5 million shares. Today, 1.5 billion shares are traded on average each day—an incredible 150-fold increase that clearly demonstrates beyond any question the amazing growth and success of our free enterprise, capitalist system. Its unparalleled freedom and opportunity have consistently attracted millions of ambitious people from all around the world who have materially increased our productivity and inventiveness. It has led to an unprecedented increase in our standard of living, so that the vast majority of Americans and all areas of our population are better off than they were before. There are always problems that need to be recognized and solved. But our system is the most successful in the world, and it offers remarkable opportunities to grow and advance to those who are willing to work, train, and educate themselves. The 100 charts in Chapter 1 are only a small sample of big past investment opportunities.

Normal bear markets show three legs of price movement down, but there's no rule saying you can't have four or even five down legs. You have to evaluate overall conditions and events in the country objectively and let the market averages tell their own story. And you have to understand what that story is.

Additional Ways to Identify Key Market Turning Points

Look for Divergence of Key Averages

Several averages should be checked at market turning points to see if there are significant divergences, meaning that they are moving in different directions (one up and one down) or that one index is advancing or declining at a much greater rate than another.

For example, if the Dow is up 100 and the S&P 500 is up only the equivalent of 20 on the Dow for the day (the S&P 500 being a broader index), it would indicate the rally is not as broad and strong as it appears. To compare the change in the S&P 500 to that in the Dow, divide the S&P 500 into the Dow average and then multiply by the change in the S&P 500.

For example, if the Dow closed at 9,000 and the S&P 500 finished at 900, the 9,000 Dow would be 10 times the S&P 500. Therefore, if the Dow, on a particular day, is up 100 points and the S&P 500 is up 5 points, you can multiply the 5 by 10 and find that the S&P 500 was up only the equivalent of 50 points on the Dow.

The Dow's new high in January 1984 was accompanied by a divergence in the indexes: the broader-based, more significant S&P 500 did not hit a new high. This is the reason most professionals plot the key indexes together—to make it easier to spot nonconfirmations at key turning points. Institutional investors periodically run up the 30-stock Dow while they liquidate the broader Nasdaq or a list of technology stocks under cover of the Dow run-up. It's like a big poker game, with players hiding their hands, bluffing, and faking.

Certain Psychological Market Indicators Might at Times Help

Now that trading in *put* and *call* options is the get-rich-quick scheme for many speculators, you can plot and analyze the ratio of calls to puts for another valuable insight into crowd temperament. Options traders buy calls, which are options to buy common stock, or puts, which are options to sell common stock. A call buyer hopes prices will rise; a buyer of put options wishes prices to fall.

If the volume of call options in a given period of time is greater than the volume of put options, a logical assumption is that option speculators as a group are expecting higher prices and are bullish on the market. If the volume of put options is greater than that of calls, speculators hold a bearish attitude. When option players buy more puts than calls, the put-to-call ratio index rises a little above 1.0. Such a reading coincided with general market bottoms in 1990, 1996, 1998, and April and September 2001, but you can't always expect this to occur. These are contrary indicators.

The *percentage of investment advisors who are bearish* is an interesting measure of investor sentiment. When bear markets are near the bottom, the great majority of advisory letters will usually be bearish. Near market tops, most will be bullish. The majority is usually wrong when it's most important to be right. However, you cannot blindly assume that because 65% of investment advisors were bearish the last time the general market hit bottom, a major market decline will be over the next time the investment advisors' index reaches the same point.

The *short-interest ratio* is the amount of short selling on the New York Stock Exchange, expressed as a percentage of total NYSE volume. This ratio can reflect the degree of bearishness shown by speculators in the market. Along bear market bottoms, you will usually see two or three major peaks showing sharply increased short selling. There's no rule governing how high the index should go, but studying past market bottoms can give you an idea of what the ratio looked like at key market junctures.

An index that is sometimes used to measure the degree of speculative activity is the *Nasdaq volume as a percentage of NYSE volume*. This measure provided a helpful tip-off of impending trouble during the summer of 1983, when Nasdaq volume increased significantly relative to the Big Board's (NYSE). When a trend persists and accelerates, indicating wild, rampant speculation, you're close to a general market correction. The volume of Nasdaq trading has grown larger than that on the NYSE in recent years because so many new entrepreneurial companies are listed on the Nasdaq, so this index must be viewed differently now.

Interpret the Overrated Advance-Dcline Line

Some technical analysts religiously follow advance-decline (A-D) data. These technicians take the number of stocks advancing each day versus the number that are declining, and then plot that ratio on a graph. Advance-decline lines are far from precise because they frequently veer sharply lower long before a bull market finally tops. In other words, the market keeps advancing toward higher ground, but it is being led by fewer but better stocks.

The advance-decline line is simply not as accurate as the key general market indexes because analyzing the market's direction is not a simple total numbers game. Not all stocks are created equal; it's better to know where the real leadership is and how it's acting than to know how many more mediocre stocks are advancing and declining.

The NYSE A-D line peaked in April 1998 and trended lower during the new bull market that broke out six months later in October. The A-D line continued to fall from October 1999 to March 2000, missing one of the market's most powerful rallies in decades.

An advance-decline line can sometimes be helpful when a clear-cut bear market attempts a short-term rally. If the A-D line lags the market averages and can't rally, it's giving an internal indication that, despite the strength of the rally in the Dow or S&P, the broader market remains frail. In such instances, the rally usually fizzles. In other words, it takes more than just a few leaders to make a new bull market.

At best, the advance-decline line is a secondary indicator of limited value. If you hear commentators or TV market strategists extolling its

virtues bullishly or bearishly, they probably haven't done their homework. No secondary measurements can be as accurate as the major market indexes, so you don't want to get confused and overemphasize the vast array of other technical measures that most people use, usually with lackluster or damaging results.

Watch Federal Reserve Board Rate Changes

Among fundamental general market indicators, changes in the Federal Reserve Board's discount rate (the interest rate the FRB charges member banks for loans), the fed funds rate (the interest rate banks with fund reserves charge for loans to banks without fund reserves), and occasionally stock margin levels are valuable indicators to watch.

As a rule, interest rates provide the best confirmation of basic economic conditions, and changes in the discount rate and the fed funds rate are by far the most reliable. In the past, three successive significant hikes in Fed interest rates have generally marked the beginning of bear markets and impending recessions.

Bear markets have usually, but not always, ended when the rate was finally lowered. On the downside, the discount rate increase to 6% in September 1987, just after Alan Greenspan became chairman, led to the severe market break that October.

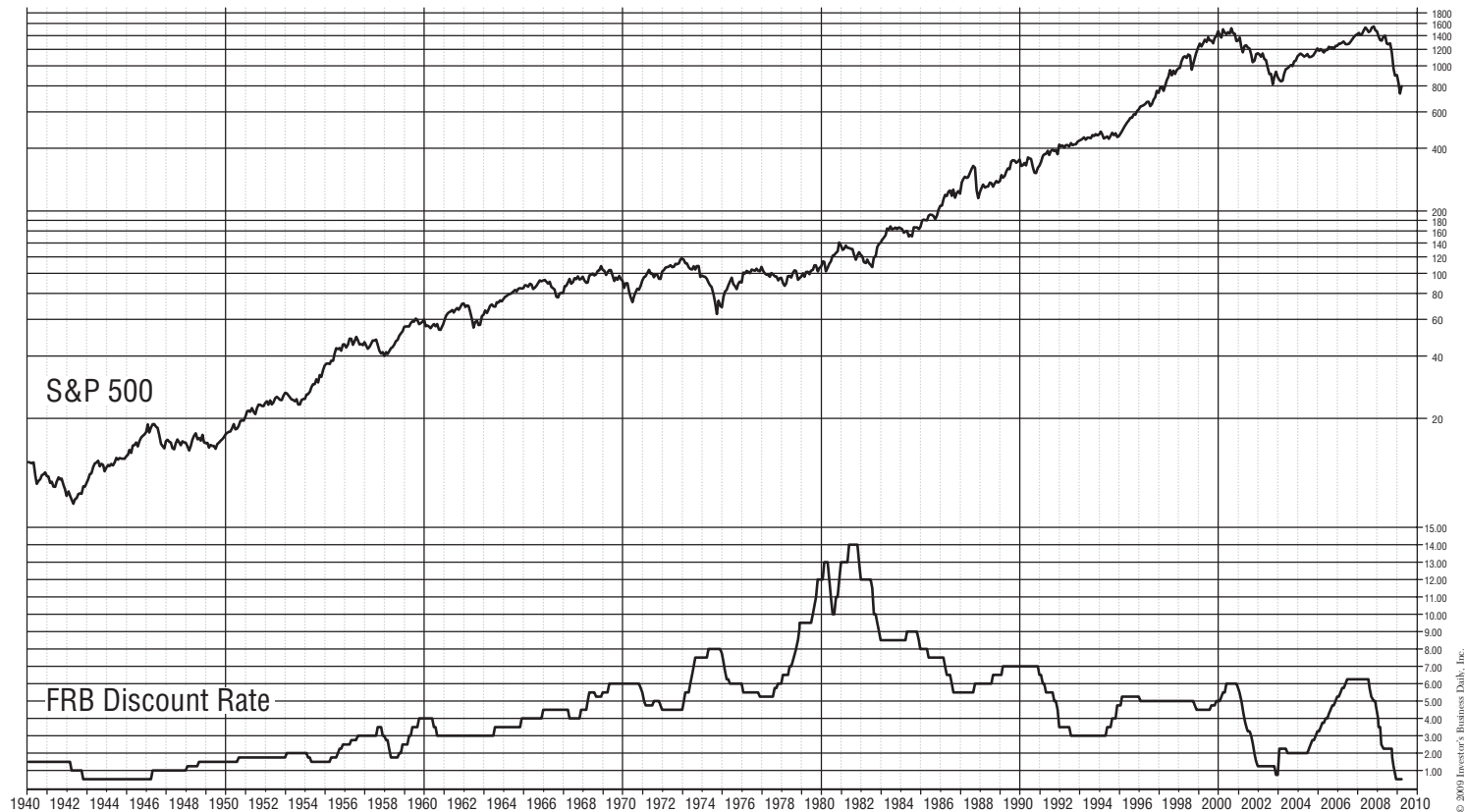
Money market indicators mirror general economic activity. At times I have followed selected government and Federal Reserve Board measurements, including 10 indicators of the supply and demand for money and indicators of interest-rate levels. History proves that the direction of the general market, and also that of several industry groups, is often affected by changes in interest rates because the level of interest rates is usually tied to tight or easy Fed monetary policy.

For the investor, the simplest and most relevant monetary indicators to follow and understand are the changes in the discount rate and fed funds rate.

With the advent of program trading and various hedging devices, some funds now hedge portions of their portfolio in an attempt to provide some downside protection during risky markets. The degree to which these hedges are successful again depends greatly on skill and timing, but one possible effect for some managers may be to lessen the pressure to dump portfolio securities on the market.

Most funds operate with a policy of being widely diversified and fully or nearly fully invested at all times. This is because most fund managers, given the great size of today's funds (billions of dollars), have difficulty getting out of the market and into cash at the right time and, most importantly, then getting back into the market fast enough to participate in the initial power-

S&P 500 Index and Federal Reserve Board Discount Rate



ful rebound off the ultimate bottom. So they may try to shift their emphasis to big-cap, semidefensive groups.

The Fed Crushes the 1981 Economy. The bear market and the costly, protracted recession that began in 1981, for example, came about solely because the Fed increased the discount rate in rapid succession on September 26, November 17, and December 5 of 1980. Its fourth increase, on May 8, 1981, thrust the discount rate to an all-time high of 14%. That finished off the U.S. economy, our basic industries, and the stock market for the time being.

Fed rate changes, however, should not be your primary market indicator because the stock market itself is always your best barometer. Our analysis of market cycles turned up three key market turns that the discount rate did not help predict.

Independent Fed actions are typically very constructive, as the Fed tries to counteract overheated excesses or sharp contractions in our economy. However, its actions and results clearly demonstrate how much our overall federal government, not our stock markets reacting to all events, can and does at times significantly influence our economic future, for good or bad.

The 2008 Financial Collapse. The subprime mortgage meltdown and financial credit crisis that led to the 2008 market collapse can be easily traced to moves in 1995 by the then-current administration to substantially beef up the Community Reinvestment Act (CRA) of 1977. These actions mandated banks to make more higher-risk loans in lower-income areas than they would otherwise have made. Failure to comply meant stiff penalties, lawsuits, and limits on getting approvals for mergers and branch expansion.

Our government, in effect, encouraged and coerced major banks to lower their long-proven safe-lending standards. Most of the more than \$1 trillion of new subprime CRA loans had adjustable rates. Many such loans eventually came to require no documentation of the borrower's income and in some cases little or no down payment.

In addition, for the first time, new regulatory rules not only allowed but encouraged lenders to bundle the new, riskier subprime loans with prime loans and sell these assumed government-sponsored loan packages to other institutions and countries that thought they were buying safe AAA bonds. The first of these bundled loans hit the investment market in 1997. That action allowed loan originators and big banks to make profits faster and eliminate future risk and responsibility for many of those lower-quality loans. It let the banks turn around and make even more CRA-type loans, then sell them off in packages again, with little future risk or responsibility.

The unintended result was a gigantic government-sponsored and aggressively promoted pyramiding device, with Fannie Mae and Freddie Mac providing the implied government backing by buying, at government's direction, vast quantities of far more subprimes; this led to their facing bankruptcy and needing enormous government bailouts. Freddie and Fannie's management also received huge bonuses and were donors to certain members of Congress, who repeatedly defended the highly leveraged, extremely risky lending against any sound reforms.

Bottom line: it was a Big Government program that started with absolutely good, worthy social intentions, but with little judgment and absolutely zero foresight that over time resulted in severe damage and enormous unintended consequences that affected almost everything and everyone, including, sadly, the very lower-income people this rather inept government operation was supposed to be helping. It put our whole financial system in jeopardy. Big Wall Street firms got involved after the rescinding of the Glass-Steagall Act in 1998, and both political parties, Congress, and the public all played key parts in creating the great government financial fiasco.

The 1962 Stock Market Break. Another notable stock market break occurred in 1962. In the spring, nothing was wrong with the economy, but the market got skittish after the government announced an investigation of the stock market and then got on the steel companies for raising prices. IBM dropped 50%. That fall, after the Cuban missile showdown with the Russians, a new bull market sprang to life. All of this happened with no change in the discount rate.

There have also been situations in which the discount rate was lowered six months after the market bottom was reached. In such cases, you would be late getting into the game if you waited for the discount rate to drop. In a few instances, after Fed rate cuts occurred, the markets continued lower or whipsawed for several months. This also occurred dramatically in 2000 and 2001.

The Hourly Market Index and Volume Changes

At key turning points, an active market operator can watch the market indexes and volume changes hour by hour and compare them to volume in the same hour of the day before.

A good time to watch hourly volume figures is during the first attempted rally following the initial decline off the market peak. You should be able to see if volume is dull or dries up on the rally. You can also see if the rally starts to fade late in the day, with volume picking up as it does, a sign that the rally is weak and will probably fail.

Hourly volume data also come in handy when the market averages reach an important prior low point and start breaking that "support" area. (A sup-

port area is a previous price level below which investors hope that an index will not fall.) What you want to know is whether selling picks up dramatically or by just a small amount as the market collapses into new low ground. If selling picks up dramatically, it represents significant downward pressure on the market.

After the market has undercut previous lows for a few days, but on only slightly higher volume, look for either a volume dry-up day or one or two days of increased volume without the general market index going lower. If you see this, you may be in a “shakeout” area (when the market pressures many traders to sell, often at a loss), ready for an upturn after scaring out weak holders.

Overbought and Oversold: Two Risky Words

The short-term overbought/oversold indicator has an avid following among some individual technicians and investors. It's a 10-day moving average of advances and declines in the market. But be careful. At the start of a new bull market, the overbought/oversold index can become substantially “overbought.” This should *not* be taken as a sign to sell stocks.

A big problem with indexes that move counter to the trend is that you always have the question of how bad things can get before everything finally turns. Many amateurs follow and believe in overbought/oversold indicators.

Something similar can happen in the early stage or first leg of a major bear market, when the index can become unusually oversold. This is really telling you that a bear market may be imminent. The market was “oversold” all the way down during the brutal market implosion of 2000.

I once hired a well-respected professional who relied on such technical indicators. During the 1969 market break, at the very point when everything told me the market was getting into serious trouble, and I was aggressively trying to get several portfolio managers to liquidate stocks and raise large amounts of cash, he was telling them that it was too late to sell because his overbought/oversold indicator said that the market was already very oversold. You guessed it: the market then split wide open.

Needless to say, I rarely pay attention to overbought/oversold indicators. What you learn from years of experience is usually more important than the opinions and theories of experts using their many different favorite indicators.

Other General Market Indicators

Upside/downside volume is a short-term index that relates trading volume in stocks that close up in price for the day to trading volume in stocks that close down. This index, plotted as a 10-week moving average, may show divergence at some intermediate turning points in the market. For example, after

a 10% to 12% dip, the general market averages may continue to penetrate into new low ground for a week or two. Yet the upside/downside volume may suddenly shift and show steadily increasing upside volume, with downside volume easing. This switch usually signals an intermediate-term upturn in the market. But you'll pick up the same signals if you watch the changes in the daily Dow, Nasdaq, or S&P 500 and the market volume.

Some services measure the *percentage of new money flowing into corporate pension funds* that is invested in common stocks and the percentage that is invested in cash equivalents or bonds. This opens another window into institutional investor psychology. However, majority—or crowd—thinking is seldom right, even when it's done by professionals. Every year or two, Wall Street seems to be of one mind, with everyone following each other like a herd of cattle. Either they all pile in or they all pile out.

An *index of "defensive" stocks*—more stable and supposedly safer issues, such as utilities, tobaccos, foods, and soaps—may often show strength after a couple of years of bull market conditions. This may indicate the "smart money" is slipping into defensive positions and that a weaker general market lies ahead. But this doesn't always work. None of these secondary market indicators is anywhere near as reliable as the key general market indexes.

Another indicator that is helpful at times in evaluating the stage of a market cycle is the *percentage of stocks in defensive or laggard categories that are making new price highs*. In pre-1983 cycles, some technicians rationalized their lack of concern with market weakness by citing the number of stocks that were still making new highs. But analysis of new-high lists shows that a large percentage of preferred or defensive stocks signals possible bear market conditions. Superficial knowledge can hurt you in the stock market.

To summarize this complex but vitally important chapter: learn to interpret the daily price and volume changes of the general market indexes and the action of individual market leaders. Once you know how to do this correctly, you can stop listening to all the costly, uninformed, personal market opinions of amateurs and professionals alike. As you can see, **the key to staying on top of the stock market is not predicting or knowing what the market is going to do. It's knowing and understanding what the market has actually done in the past few weeks and what it is currently doing now.** We don't want to give personal opinions or predictions; we carefully observe market supply and demand as it changes day by day.

One of the great values of this system of interpreting the price and volume changes in the market averages is not just the ability to better recognize market top and bottom areas but also the ability to track each rally attempt when the market is on its way down. In most instances, waiting for

powerful follow-through days keeps you from being drawn prematurely into rally attempts that ultimately end in failure. In other words, you have rules that will continue to keep you from getting sucked into phony rallies. This is how we were able to stay out of the market and in money market funds for most of 2000 through 2002, preserve the majority of the gains we had made in 1998 and 1999, and help those who read and followed our many basic rules. There is a fortune for you in this paragraph.

Part I Review: How to Remember and Use What You've Read So Far

It isn't enough just to read. You need to remember and apply *all* of what you've read. The CAN SLIM system will help you remember what you've read so far. Each letter in the CAN SLIM system stands for one of the seven basic fundamentals of selecting outstanding stocks. Most successful stocks have these seven common characteristics at emerging growth stages, so they are worth committing to memory. Repeat the formula until you can recall and use it easily. Keep it with you when you invest.

C = Current Quarterly Earnings per Share. Quarterly earnings per share must be up at least 18% or 20%, but preferably up 40% to 100% or 200% or more—the higher, the better. They should also be accelerating at some point in recent quarters. Quarterly sales should also be accelerating or up 25% or more.

A = Annual Earnings Increases. There must be significant (25% or more) growth in each of the last three years and a return on equity of 17% or more (with 25% to 50% preferred). If return on equity is too low, pretax profit margin must be strong.

N = New Products, New Management, New Highs. Look for new products or services, new management, or significant new changes in industry conditions. And most important, buy stocks as they emerge from sound, properly formed chart bases and begin to make new highs in price.

S = Supply and Demand—Shares Outstanding plus Big Volume Demand. Any size capitalization is acceptable in today's new economy as long as a company fits all the other CAN SLIM rules. Look for big volume increases when a stock begins to move out of its basing area.

L = Leader or Laggard. Buy market leaders and avoid laggards. Buy the number one company in its field or space. Most leaders will have Relative Price Strength Ratings of 80 to 90 or higher and composite ratings of 90 or more in bull markets.

I = Institutional Sponsorship. Buy stocks with increasing sponsorship and at least one or two mutual fund owners with top-notch recent performance records. Also look for companies with management ownership.

M = Market Direction. Learn to determine the overall market direction by accurately interpreting the daily market indexes' price and volume movements and the action of individual market leaders. This can determine whether you win big or lose. You need to stay in gear with the market. It doesn't pay to be out of phase with the market.

Is CAN SLIM Momentum Investing?

I'm not even sure what "momentum investing" is. Some analysts and reporters who don't understand anything about how we invest have given that name to what we talk about and do. They say it's "buying the stocks that have gone up the most in price" and that have the strongest relative price strength. No one in their right mind invests that way. What we do is identify companies with strong fundamentals—large sales and earnings increases resulting from unique new products or services—and then buy their stocks when they emerge from properly formed price consolidation periods and before they run up dramatically in price during bull markets.

When bear markets are beginning, we want people to protect themselves and nail down their gains by knowing when to sell and start raising cash. We are not investment advisors. We do not write and disseminate any research reports. We do not call or visit companies. We do not make markets in stocks, deal in derivatives, do underwritings, or arrange mergers. We don't manage any public or institutional money.

We are historians, studying and discovering how stocks and markets actually work and teaching and training people everywhere who want to make money investing intelligently and realistically. These are ordinary people from all walks of life, including professionals. We do not give them fish. We teach them how to fish for their whole future so that they too can capitalize on the American Dream.

Experts, Education, and Egos

On Wall Street, wise men can be drawn into booby traps just as easily as fools. From what I've seen over many years, the length and quality of one's education and the level of one's IQ have very little to do with making money investing in the market. The more intelligent people are—particularly men—the more they think they really know what they're doing, and the more they may have to learn the hard way how little they really know about outsmarting the markets.

We've all now witnessed firsthand the severe damage that supposedly bright, intelligent, and highly educated people in New York and Washington, D.C., caused this country in 2008. U.S. senators, heads of congressional committees, political types working for government-sponsored entities such as Fannie Mae and Freddie Mac, plus heads of top New York-based brokerage firms, lending banks, and mortgage brokers all thought they knew what they were doing, with many of them using absurd leverage of 50 to 1, and even higher, to invest in subprime real estate loans.

They created sophisticated derivatives and insurance to justify such incredible risks. No one group was solely to blame, since both Democrats and Republicans were involved. However, it all began as a well-intended government program that top politicians accelerated in 1995, 1997, and 1998, when Glass-Steagall was rescinded, and things kept escalating out of control. Politicians accept no blame, just blame others.

So maybe it's time for you to take more control of your investing and make up your mind that you're going to learn how to save and invest your hard-earned money more safely and wisely than Washington and Wall Street have done since the late 1990s. If you really want to do it, you certainly can. Anyone can.

The few people I've known over the years who've been unquestionably successful investing in America were decisive individuals without huge egos. The market has a simple way of whittling all excessive pride and overblown egos down to size. After all, the whole idea is to be completely objective and recognize what the marketplace is telling you, rather than trying to prove that what you said or did yesterday or six weeks ago was right. The fastest way to take a bath in the stock market is to try to prove that you are right and the market is wrong. Humility and common sense provide essential balance.

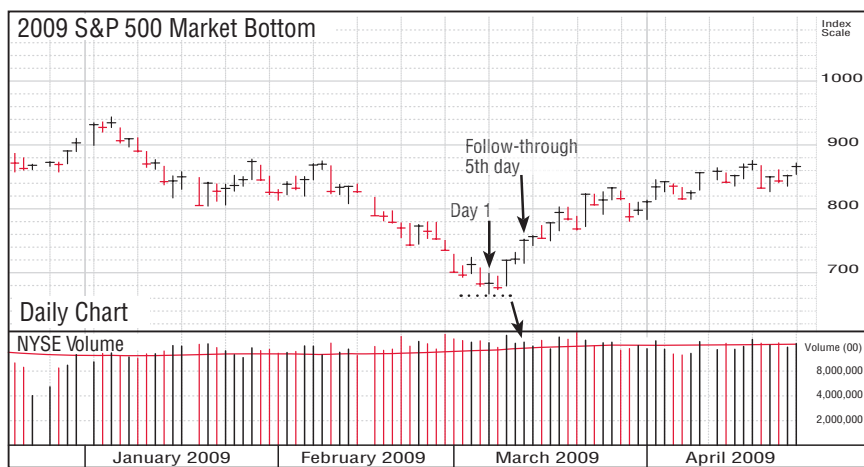
Sometimes, listening to quoted and accepted experts can get you into trouble. In the spring and summer of 1982, a well-known expert insisted that government borrowing was going to crowd out the private sector and that interest rates and inflation would soar back to new highs. Things turned out exactly the opposite: inflation broke and interest rates came crashing down. Another expert's bear market call in the summer of 1996 came only one day before the market bottom.

Week after week during the 2000 bear market, one expert after another kept saying on CNBC that it was time to buy high-tech stocks—only to watch the techs continue to plummet further. Many high-profile analysts and strategists kept telling investors to capitalize on these once-in-a-lifetime “buying opportunities” on the way down! Buying on the way down can be a very dangerous pastime.

Conventional wisdom or consensus thinking in the market is seldom right. I never pay any attention to the parade of experts voicing their personal opinions on the market in print or on TV. It creates entirely too much confusion and can cost you a great deal of money. In 2000, some strategists were telling people to buy the dips (short-term declines in price) because the cash position of mutual funds had increased greatly and all this money was sitting on the sidelines waiting to be invested. To prove this wrong, all anyone had to do was look at the General Markets & Sectors page in *Investor's Business Daily*. It showed that while mutual fund cash positions had indeed risen, they were still significantly below their historical highs and even below their historical averages.

On the flip side, market bottoms are often accompanied by overwhelming negativity from the “experts.” For example, in March 2009 investors had just faced a financial crisis, 17-month bear market, and the president warning of the possibility of another Great Depression. Most people, understandably, were afraid to jump back into the market despite the follow-through day on March 12 (see chart below).

You can't go by how you *feel* in the market. The only thing that works well is to let the market indexes tell you when it's time to enter and exit. Never fight the market—it's bigger than you are.



II

• PART •

**Be Smart
from
the Start**

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10

• CHAPTER •

When You Must Sell and Cut Every Loss . . . without Exception

Now that you've learned how and when to buy nothing but the best stocks, it's time for you to learn how and when to sell them. You've probably heard the sports cliché: "The best offense is a strong defense." The funny thing about clichés is they are usually true: a team that's all offense and no defense seldom wins the game. In fact, a strong defense can often propel a team to great heights.

During their heyday, when Branch Rickey was president and general manager, the Brooklyn Dodgers typically had good pitching. In the game of baseball, the combination of pitching and fielding represents the defensive side of a team and maybe 70% of the game. It's almost impossible to win without them.

The same holds true in the stock market. Unless you have a strong defense to protect yourself against large losses, you absolutely can't win big in the game of investing.

Bernard Baruch's Secret Market Method of Making Millions

Bernard Baruch, a famous market operator on Wall Street and trusted advisor to U.S. presidents, said it best: "If a speculator is correct half of the time, he is hitting a good average. Even being right 3 or 4 times out of 10 should yield a person a fortune if he has the sense to cut his losses quickly on the ventures where he has been wrong."

As you can see, even the most successful investors make many mistakes. These poor decisions will lead to losses, some of which can become quite

awful if you're not disciplined and careful. No matter how smart you are, how high your IQ, how advanced your education, how good your information, or how sound your analysis, you're simply not going to be right all the time. In fact, you'll probably be right less than half the time! You positively must understand and accept that the first rule for the highly successful individual investor is . . . always cut short and limit every single loss. To do this takes never-ending discipline and courage.

Marc Mandell of *Winning on Wall Street* has been reading *Investor's Business Daily* since 1987. He likes it for its many moneymaking ideas and its emphasis on risk-management strategies. "Lose small and win big," he believes, "is the holy grail of investing."

Baruch's point about cutting losses was driven home to me by an account that I managed back in 1962. The general market had taken a 29% nose-dive, and we were right on only one of every three commitments we had made in this account. Yet at the end of the year, the account was ahead. The reason was that the average profit on the 33% of decisions that were correct was more than twice the average of the small losses we took when we were off-target.

I like to follow a 3-to-1 ratio between where to sell and take profits and where to cut losses. If you take some 20% to 25% gains, cut your losses at 7% or 8%. If you're in a bear market like 2008 and you buy any stocks at all, you might get only a few 10% or 15% gains, so I'd move quickly to cut every single loss automatically at 3%, with no exceptions.

The whole secret to winning big in the stock market is not to be right all the time, but to lose the least amount possible when you're wrong.

You've got to recognize when you may be wrong and sell without hesitation to cut short every one of your losses. It's your job to get in phase with the market and not try to get the market in phase with you.

How can you tell when you may be wrong? That's easy: the price of the stock drops below the price you paid for it! Each point your favorite brain-child falls below your cost increases both the chance you're wrong and the price you're going to pay for being wrong. So get realistic.

Are Successful People Lucky or Always Right?

People think in order to be successful, you have to be either lucky or right most of the time. Not so. Successful people make many mistakes, and their success is due to hard work, not luck. They just try harder and more often than the average person. There aren't many overnight successes; success takes time.

In search of a filament for his electric lamp, Thomas Edison carbonized and tested 6,000 specimens of bamboo. Three of them worked. Before that, he had tried thousands of other materials, from cotton thread to chicken feathers.

Babe Ruth worked so hard for his home run record that he also held the lifetime record for strikeouts. Irving Berlin wrote more than 600 songs, but no more than 50 were hits. The Beatles were turned down by every record company in England before they made it big. Michael Jordan was once cut from his high school basketball team, and Albert Einstein made an F in math. (It also took him many years to develop and prove his theory of relativity.)

It takes a lot of trial and error before you can nail down substantial gains in stocks like Brunswick and Great Western Financial when they doubled in 1961, Chrysler and Syntex in 1963, Fairchild Camera and Polaroid in 1965, Control Data in 1967, Levitz Furniture in 1970–1972, Prime Computer and Humana in 1977–1981, MCI Communications in 1981–1982, Price Company in 1982–1983, Microsoft in 1986–1992, Amgen in 1990–1991, International Game Technology in 1991–1993, Cisco Systems from 1995 to 2000, America Online and Charles Schwab in 1998–1999, and Qualcomm in 1999. These stocks dazzled the market with gains ranging from 100% to more than 1,000%.

Over the years, I've found that only one or two out of ten stocks that I've bought turned out to be truly outstanding and capable of making this kind of substantial profits. In other words, to get the one or two stocks that make big money, you have to look for and buy ten.

Which begs the question, what do you do with the other eight? Do you sit with them and hope, the way most people do? Or do you sell them and keep trying until you come up with even bigger successes?

When Does a Loss Become a Loss?

When you say, "I can't sell my stock because I don't want to take a loss," you assume that what you want has some bearing on the situation. But the stock doesn't know who you are, and it couldn't care less what you hope or want.

Besides, selling doesn't give you the loss; you already have the loss. If you think you haven't incurred a loss until you sell the stock, you're kidding yourself. The larger the paper loss, the more real it will become. If you paid \$40 per share for 100 shares of Can't Miss Chemical, and it's now worth \$28 per share, you have \$2,800 worth of stock that cost you \$4,000. You have a \$1,200 loss. Whether you convert the stock to cash or hold it, it's still worth only \$2,800.

Even though you didn't sell, you took your loss when the stock dropped in price. You'd be better off selling and going back to a cash position where you can think far more objectively.

When you're holding on to a big loss, you're rarely able to think straight. You get emotional. You rationalize and say, "It can't go any lower." However, keep in mind that there are many other stocks to choose from where your chance of recouping your loss could be greater.

Here's another suggestion that may help you decide whether to sell: pretend that you don't own the stock and you have \$2,800 in the bank. Then ask yourself, "Do I really want to buy this stock now?" If your answer is no, then why are you holding onto it?

Always, without Exception, Limit Your Losses to 7% or 8% of Your Cost

Individual investors should definitely set firm rules limiting the loss on the initial capital they have invested in each stock to an absolute maximum of 7% or 8%. Institutional investors who lessen their overall risk by taking large positions and diversifying broadly are unable to move into and out of stocks quickly enough to follow such a loss-cutting plan. This is a terrific advantage you, the nimble decisive individual investor, have over the institutions. So use it, or lose your edge.

When the late Gerald M. Loeb of E. F. Hutton was writing his last book on the stock market, he came down to visit me in Los Angeles, and I had the pleasure of discussing this idea with him. In his first work, *The Battle for Investment Survival*, Loeb advocated cutting all losses at 10%. I was curious and asked him if he always followed the 10% loss policy himself. "I would hope," he replied, "to be out long before they ever reach 10%." Loeb made millions in the market.

Bill Astrop, president of Astrop Advisory Corp. in Atlanta, Georgia, suggests a minor revision of the 10% loss-cutting plan. He thinks that individual investors should sell half of their position in a stock if it is down 5% from their cost and the other half once it's down 10%. This is sound advice.

To preserve your hard-earned money, I think a 7% or 8% loss should be the absolute limit. The average of all your losses should be less, perhaps 5% or 6%, if you're strictly disciplined and fast on your feet. If you can keep the average of all your mistakes and losses to 5% or 6%, you'll be like the football team on which opponents can never move the ball. If you don't give up many first downs, how can anyone ever beat you?

Now here's a valuable secret: if you use charts to time your buys precisely off *sound* bases (price consolidation areas), your stocks will rarely drop 8% from a correct buy point. So when they do, either you've made a mistake in your selection or a general market decline may be starting. This is a big key for your future success.

Barbara James, an IBD subscriber who has attended several of our workshops, didn't know anything about stocks when she started investing after 20 years in the real estate business. She first traded on paper using the IBD rules. This worked so well that she finally had the confidence to try it with real money. That was in the late 1990s, when the market seemed to have only one direction—up. The first stock she bought using the IBD rules was EMC. When she sold it in 2000, she had a 1,300% gain. She also had a gain of over 200% in Gap. Ten years after her start, with the profits she made using IBD, she was able to pay off her house and her car.

And thanks to the 7% rule, Barbara can take advantage of the market once it improves. Before the market started to correct in the fall of 2007, she had bought three CAN SLIM stocks—Monolithic Power, China Medical, and St. Jude Medical. “I bought them all at exactly the right pivot point, and I got forced out of all three as the market started to correct in July and August,” she says. “I am happy to lose money when it's only 7% or 8%. If it hadn't been for the sell rules, I would have lost my shirt. And I wouldn't have resources for the next bull market.”

Here's what another IBD subscriber, Herb Mitchell, told us in February 2009: “Over and over again, the buy and sell rules—especially the sell rules—have been proven to work. It took me a couple of years to finally get it through my head, but then the results started to show. I spent most of 2008 on the sidelines, and I now get compliments from friends who say that they lost thousands—50% or more—in their IRA accounts while I had a 5% gain for the year. I think I should have done better, but you live and learn.”

Also, there's no rule that says you have to wait until every single loss reaches 7% to 8% before you take it. On occasion, you'll sense the general market index is under distribution (selling) or your stock isn't acting right and you are starting off amiss. In such cases, you can cut your loss sooner, when the stock may be down only one or two points.

Before the market broke wide open in October 1987, for example, there was ample time to sell and cut losses short. That correction actually began on August 26. If you're foolish enough to try bucking the market by buying stocks in bearish conditions, at least move your absolute loss-cutting point up to 3% or 4%.

After years of experience with this technique, your average losses should become less as your stock selection and timing improve and you learn to make small “follow-up buys” in your best stocks. It takes a lot of time to learn to make follow-up buys safely when a stock is up, but this method of money management forces you to move your money from slower-performing stocks into your stronger ones. I call this force-feeding. (See “My Revised Profit-and-Loss Plan,” pages 258–259 in Chapter 11.) You'll end up

selling stocks that are not yet down 7% or 8% because you are raising money to add to your best winners during clearly strong bull markets.

Remember: 7% to 8% is your absolute loss limit. You must sell without hesitation—no waiting a few days to see what might happen; no hoping the stock will rally back; no need to wait for the day's market close. Nothing but the fact you're down 7% or 8% below your cost should have a bearing on the situation at this point.

Once you're significantly ahead and have a good profit, you can afford to give the stock a good bit more room for normal fluctuations off its price peak. Do *not* sell a stock just because it's off 7% to 8% from its peak price. It's important that you definitely understand the difference.

In one case, you probably started off wrong. The stock is not acting the way you expected it to, and it is down below your purchase price. You're starting to lose your hard-earned money, and you may be about to lose a lot more. In the other case, you have begun correctly. The stock has acted better, and you have a significant gain. Now you're working on a profit, so in a bull market, you can afford to give the stock more room to fluctuate so that you don't get shaken out on a normal 10% to 15% correction.

Don't chase your stock up too far when you're buying it, however. The key is timing your stock purchases exactly at breakout points to minimize the chance that a stock will drop 8%. (See Chapter 2 for more on using charts to select stocks.)

All Common Stocks Are Speculative and Risky

There is considerable risk in all common stocks, regardless of their name, quality, purported blue-chip status, previous performance record, or current good earnings. Keep in mind that growth stocks can top at a time when their earnings are excellent and analysts' estimates are still rosy.

There are no sure things or safe stocks. Any stock can go down at any time . . . and you never know how far it can go down.

Every 50% loss began as a 10% or 20% loss. Having the raw courage to sell and take your loss cheerfully is the only way you can protect yourself against the possibility of much greater devastating losses. Decision and action should be instantaneous and simultaneous. To be a big winner, you must learn to make decisions. I've known at least a dozen educated and otherwise intelligent people who were completely wiped out solely because they would not sell and cut a loss.

What should you do if a stock gets away from you and the loss becomes greater than 10%? This can happen to anyone, and it's an even more critical sign the stock positively must be sold. It was in more trouble than normal,

so it fell faster and further than normal. In the market collapse of 2000, many new investors lost heavily, and some of them lost it all. If they had just followed the simple sell rule discussed earlier, they would have protected most of their capital. Investing is not gambling, it is investing.

In my experience, the stocks that get away from you and produce larger-than-normal losses are the truly awful selections that absolutely must be sold. Something is really going wrong with either the stock or the whole market, and it's even more urgent the stock be sold to avoid a later catastrophe.

Keep in mind that if you let a stock drop 50%, you must make 100% on your next stock just to break even! And how often do you buy stocks that double? You simply can't afford to sit with a stock where the loss keeps getting worse. Get out.

It is a dangerous fallacy to assume that because a stock goes down, it has to come back up. Many don't. Others take years to recover. AT&T hit a high of \$75 in 1964 and took 20 years to come back. Also, when the S&P 500 or Dow declines 20% to 25% in a bear market, many stocks will plummet 60% to 75%.

When the S&P dives 52%, as it did in 2008, many stocks fell 80% to 90%. Who would have projected General Motors would sell for \$2 a share, down from \$94? The auto industry is important to the United States, but it will require a serious, top-to-bottom restructuring and will possibly have to go through bankruptcy if it is to survive and compete effectively in the new highly competitive world market. For 31 years, from 1977 to 2008, GM stock's relative price strength line declined steadily. What will GM do in the future if India or China sells cars in the United States that get 50 miles per gallon and have a much lower price?

The only way to prevent bad stock market losses is to cut them without hesitation while they're still small. Always protect your account so that you can live to invest successfully another day.

In 2000, many new investors incorrectly believed all you had to do was buy high-tech stocks on every dip in price because they would always go back up and there was easy money to be made. This is an amateur's strategy, and it almost always leads to heavy losses. Semiconductor and other technology stocks are two to three times as volatile and risky as others. So if you're in these stocks, moving rapidly to cut short every loss is even more essential. If your portfolio is in nothing but high-tech stocks, or if you're heavily margined in tech stocks, you are asking for serious trouble if you don't cut your losses quickly.

You should never invest on margin unless you're willing to cut all your losses quickly. Otherwise, you could go belly-up in no time. If you get a margin call from your broker (when you're faced with the decision to either sell

stock or add money to your account to cover the lost equity in a falling stock), don't throw good money after bad. Sell some stock, and recognize what the market and your margin clerk are trying to tell you.

Cutting Losses Is Like Buying an Insurance Policy

This policy of limiting losses is similar to paying small insurance premiums. You're reducing your risk to precisely the level you're comfortable with. Yes, the stock you sell will often turn right around and go back up. And yes, this can be frustrating. But when this happens, don't ever conclude you were wrong to sell it. That exceedingly dangerous thinking will eventually get you into serious trouble.

Think about it this way: If you bought insurance on your car last year and you didn't have an accident, was your money wasted? Will you buy the same insurance this year? Of course you will! Did you take out fire insurance on your home or your business? If your home or business hasn't burned down, are you upset because you feel you made a bad financial decision? No. You don't buy fire insurance because you know your house is going to burn down. You buy insurance just in case, to protect yourself against the remote possibility of a serious loss.

It's exactly the same for the winning investor who cuts all losses quickly. It's the only way to protect against the possible or probable chance of a much larger loss from which it may not be possible to recover.

If you hesitate and allow a loss to increase to 20%, you will need a 25% gain just to break even. Wait longer until the stock is down 25%, and you'll have to make 33% to get even. Wait still longer until the loss is 33%, and you'll have to make 50% to get back to the starting gate. The longer you wait, the more the math works against you, so don't vacillate. Move immediately to cut out possible bad decisions. Develop the strict discipline to act and to always follow your selling rules.

Some people have gone so far as to let losing stocks damage their health. In this situation, it's best to sell and stop worrying. I know a stockbroker who in 1961 bought Brunswick at \$60 on the way down in price. It had been the market's super leader since 1957, increasing more than 20 times. When it dropped to \$50, he bought more, and when it dropped to \$40, he added again.

When it dropped to \$30, he dropped dead on the golf course.

History and human nature keep relentlessly repeating themselves in the stock market. In the fall of 2000, many investors made the identical mistake: they bought the prior bull market's leader, Cisco Systems, on the way down at \$70, \$60, \$50, and lower, after it had topped at \$87. Seven months later it had sunk to \$13, an 80% decline for those who bought at \$70. The moral of

the story is: never argue with the market. Your health and peace of mind are always more important than any stock.

Small losses are cheap insurance, and they're the only insurance you can buy on your investments. Even if a stock moves up after you sell it, as many surely will, you will have accomplished your critical objective of keeping all your losses small, and you'll still have money to try again for a winner in another stock.

Take Your Losses Quickly and Your Profits Slowly

There's an old investment saying that the first loss in the market is the smallest. In my view, the way to make investment decisions is to always (with no exceptions) take your losses quickly and your profits slowly. Yet most investors get emotionally confused and take their profits quickly and their losses slowly.

What is your real risk in any stock you buy when you use the method we've discussed? It's 8%, no matter what you buy, if you follow this rule religiously. Still, most investors stubbornly ask, "Shouldn't we sit with stocks rather than selling and taking a loss?" Or, "How about unusual situations where some bad news hits suddenly and causes a price decline?" Or, "Does this loss-cutting procedure apply all the time, or are there exceptions, like when a company has a good new product?" The answer: *there are no exceptions*. None of these things changes the situation one bit. You must always protect your hard-earned pool of capital.

Letting your losses run is the most serious mistake almost all investors make. You must accept the fact that mistakes in stock selection and timing are going to be made frequently, even by the most experienced of professional investors. I'd go so far as to say that if you aren't willing to cut short and limit your losses, you probably shouldn't buy stocks. Would you drive your car down the street without brakes? If you were a fighter pilot, would you go into battle without a parachute?

Should You Average Down in Price?

One of the most unprofessional things a stockbroker can do is hesitate or fail to call customers whose stocks are down in price. That's when the customer needs help the most. Shirking this duty in difficult periods shows a lack of courage under pressure. About the only thing that's worse is for brokers to take themselves off the hook by advising customers to "average down" (buy more of a stock that is already showing a loss). If I were advised to do this, I'd close my account and look for a smarter broker.

Everyone loves to buy stocks; no one loves to sell them. As long as you hold a stock, you can still hope it might come back up enough to at least get you out even. Once you sell, you abandon all hope and accept the cold reality of temporary defeat. Investors are always hoping rather than being realistic. Knowing and acting is better than hoping or guessing. The fact that you want a stock to go up so you can at least get out even has nothing to do with the action and brutal reality of the market. The market obeys only the law of supply and demand.

A great trader once noted there are only two emotions in the market: hope and fear. "The only problem," he added, "is we hope when we should fear, and we fear when we should hope." This is just as true in 2009 as it was in 1909.

The Turkey Story

Many years ago, I heard a story by Fred C. Kelly, the author of *Why You Win or Lose*, that illustrates perfectly how the conventional investor thinks when the time comes to make a selling decision:

A little boy was walking down the road when he came upon an old man trying to catch wild turkeys. The man had a turkey trap, a crude device consisting of a big box with the door hinged at the top. This door was kept open by a prop, to which was tied a piece of twine leading back a hundred feet or more to the operator. A thin trail of corn scattered along a path lured turkeys to the box.

Once they were inside, the turkeys found an even more plentiful supply of corn. When enough turkeys had wandered into the box, the old man would jerk away the prop and let the door fall shut. Having once shut the door, he couldn't open it again without going up to the box, and this would scare away any turkeys that were lurking outside. The time to pull away the prop was when as many turkeys as one could reasonably expect were inside.

One day he had a dozen turkeys in his box. Then one sauntered out, leaving 11. "Gosh, I wish I had pulled the string when all 12 were there," said the old man. "I'll wait a minute and maybe the other one will go back." While he waited for the twelfth turkey to return, two more walked out on him. "I should have been satisfied with 11," the trapper said. "Just as soon as I get one more back, I'll pull the string." Three more walked out, and still the man waited. Having once had 12 turkeys, he disliked going home with less than 8.

He couldn't give up the idea that some of the original turkeys would return. When finally there was only one turkey left in the trap, he said, "I'll wait until he walks out or another goes in, and then I'll quit." The solitary turkey went to join the others, and the man returned empty-handed.

The psychology of normal investors is not much different. They hope more turkeys will return to the box when they should fear that all the turkeys could walk out and they'll be left with nothing.

How the Typical Investor Thinks

If you're a typical investor, you probably keep records of your transactions. When you think about selling a stock, you probably look at your records to see what price you paid for it. If you have a profit, you may sell, but if you have a loss, you tend to wait. After all, you didn't invest in the market to lose money. However, what you should be doing is selling your worst-performing stock first. Keep your flower patch free of weeds.

You may decide to sell your shares in Myriad Genetics, for example, because it shows a nice profit, but you'll keep your General Electric because it still has a ways to go before it's back to the price you paid for it. If this is the way you think, you're suffering from the "price-paid bias" that afflicts 95% of all investors.

Suppose you bought a stock two years ago at \$30, and it's now worth \$34. Most investors would sell it because they have a profit. But what does the price you paid two years ago have to do with what the stock is worth now? And what does it have to do with whether you should hold or sell the stock? The key is the relative performance of this stock versus others you either own or could potentially own.

Analyzing Your Activities

To help you avoid the price-paid bias, particularly if you are a longer-term investor, I suggest you use a different method of analyzing your results. At the end of each month or quarter, compute the percentage change in the price of each stock from the last date you did this type of analysis. Now list your investments in order of their relative price performance since your previous evaluation period. Let's say Caterpillar is down 6%, ITT is up 10%, and General Electric is down 10%. Your list would start with ITT on top, then Caterpillar, then GE. At the end of the next month or quarter, do the same thing. After a few reviews, you will easily recognize the stocks that are not doing well. They'll be at the bottom of the list; those that did best will be at or near the top.

This method isn't foolproof, but it does force you to focus your attention not on what you paid for your stocks, but on the relative performance of your investments in the market. It will help you maintain a clearer perspective. Of course, you have to keep records of your costs for tax reasons, but

you should use this more realistic method in the longer-term management of your portfolio. Doing this more often than once a quarter can only help you. Eliminating the price-paid bias can be profitable and rewarding.

Any time you make a commitment to a security, you should also determine the potential profit and possible loss. This is only logical. You wouldn't buy a stock if there were a potential profit of 20% and a potential loss of 80%, would you? But if you don't try to define these factors and operate by well-thought-out rules, how do you know this isn't the situation when you make your stock purchase? Do you have specific selling rules you've written down and follow, or are you flying blind?

I suggest you write down the price at which you expect to sell if you have a loss (8% or less below your purchase price) along with the expected profit potential of all the securities you purchase. For instance, you might consider selling your growth stock when its P/E ratio increases 100% or more from the time the stock originally began its big move out of its initial base pattern.

If you write these numbers down, you'll more easily see when the stock has reached one of these levels.

It's bad business to base your sell decisions on your cost and hold stocks down in price simply because you can't accept the fact you made an imprudent selection and lost money. In fact, you're making the exact opposite decisions from those you would make if you were running your own business.

The Red Dress Story

Investing in the stock market is really no different from running your own business. Investing is a business and should be operated as such. Assume that you own a small store selling women's clothing. You've bought and stocked women's dresses in three colors: yellow, green, and red. The red dresses go quickly, half the green ones sell, and the yellows don't sell at all.

What do you do about it? Do you go to your buyer and say, "The red dresses are all sold out. The yellow ones don't seem to have any demand, but I still think they're good. Besides, yellow is my favorite color, so let's buy some more of them anyway"?

Certainly not!

The clever merchandiser who survives in the retail business looks at this predicament objectively and says, "We sure made a mistake. We'd better get rid of the yellow dresses. Let's have a sale. Mark them down 10%. If they don't sell at that price, mark them down 20%. Let's get our money out of those 'old dogs' no one wants, and put it into more of the hot-moving red

dresses that are in demand.” This is common sense in any retail business. Do you do this with your investments? Why not?

Everyone makes buying errors. The buyers for department stores are pros, but even they make mistakes. If you do slip up, recognize it, sell, and go on to the next thing. You don’t have to be correct on all your investment decisions to make a good net profit.

Now you know the real secret to reducing your risk and selecting the best stocks: stop counting your turkeys and get rid of your yellow dresses!

Are You a Speculator or an Investor?

There are two often-misunderstood words that are used to describe the kinds of people who participate in the stock market: speculator and investor. When you think of the word *speculator*, you might think of someone who takes big risks, gambling on the future success of a stock. Conversely, when you think of the word *investor*, you might think of someone who approaches the stock market in a sensible and rational manner. According to these conventional definitions, you may think it’s smarter to be an investor.

Baruch, however, defined *speculator* as follows: “The word speculator comes from the Latin ‘speculari,’ which means to spy and observe. A speculator, therefore, is a person who observes and acts before [the future] occurs.” This is precisely what you should be doing: watching the market and individual stocks to determine what they’re doing now, and then acting on that information.

Jesse Livermore, another stock market legend, defined *investor* this way: “Investors are the big gamblers. They make a bet, stay with it, and if it goes wrong, they lose it all.” After reading this far, you should already know this is not the proper way to invest. There’s no such thing as a long-term investment once a stock drops into the loss column and you’re down 8% below your cost.

These definitions are a bit different from those you’ll read in Webster’s Dictionary, but they are far more accurate. Keep in mind that Baruch and Livermore at many times made millions of dollars in the stock market. I’m not sure about lexicographers.

One of my goals is to get you to question many of the faulty investment ideas, beliefs, and methods that you’ve heard about or used in the past. One of these is the very notion of what it means to invest. It’s unbelievable how much erroneous information about the stock market, how it works, and how to succeed at it is out there. Learn to objectively analyze all the relevant facts about a stock and about how the market is behaving. Stop listening to and being influenced by friends, associates, and the continuous array of experts’ personal opinions on daily TV shows.

For Safety, Why Not Diversify Widely?

Wide diversification is a substitute for lack of knowledge. It sounds good, and it's what most people advise. But in a bad bear market, almost all of your stocks will go down, and you could lose 50% percent or more in some stocks that will never come back. So diversification is a poor substitute for a sound defensive plan with rules to protect your account. Also, if you have 20 or 30 stocks and you sell 3 or 4, it won't help you when you lose heavily on the rest.

"I'm Not Worried; I'm a Long-Term Investor, and I'm Still Getting My Dividends"

It's also risky and probably foolish to say to yourself, "I'm not worried about my stocks being down because they are good stocks, and I'm still getting my dividends." Good stocks bought at the wrong time can go down as much as poor stocks, and it's possible they might not be such good stocks in the first place. It may just be your personal opinion they're good.

Furthermore, if a stock is down 35% in value, isn't it rather absurd to say you're all right because you are getting a 4% dividend yield? A 35% loss plus a 4% income gain equals a whopping 31% net loss.

To be a successful investor, you must face facts and stop rationalizing and hoping. No one emotionally wants to take losses, but to increase your chances of success in the stock market, you have to do many things you don't want to do. Develop precise rules and hard-nosed selling disciplines, and you'll gain a major advantage. You can do this.

Never Lose Your Confidence

There's one last critical reason for you to take losses before they have a chance to really hurt you: never lose your courage to make decisions in the future. If you don't sell to cut your losses when you begin to get into trouble, you can easily lose the confidence you'll need to make buy and sell decisions in the future. Or, far worse, you can get so discouraged that you finally throw in the towel and get out of the market, never realizing what you did wrong, never correcting your faulty procedures, and giving up all the future potential the stock market—one of the most outstanding opportunities in America—has to offer.

Wall Street is human nature on daily display. Buying and selling stocks properly and making a net profit are always a complicated affair. Human nature being what it is, 90% of people in the stock market—professionals and amateurs alike—simply haven't done much homework. They haven't

really studied to learn whether what they're doing is right or wrong. They haven't studied in enough detail what makes a successful stock go up and down. Luck has nothing to do with it, and it's not a total mystery. And it certainly isn't a "random walk" or an efficient market, as some inexperienced university professors formerly believed.

It takes some work to become really good at stock selection, and still more to know how and when to sell. Selling a stock correctly is a tougher job and the one that is least understood by everyone. To do it right, you need a plan to cut losses and the discipline to do this quickly without wavering.

Forget your ego, swallow your pride, stop trying to argue with the market, and don't get emotionally attached to any stock that's losing you money. Remember: there are no good stocks; they're all bad . . . unless they go up in price. Learn from the 2000 and 2008 experience. Those who followed our selling rules protected their capital and nailed down gains. Those who did not have or follow any selling rules got hurt.

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• CHAPTER •

When to Sell and Take Your Worthwhile Profits

This is one of the most vital chapters in this book, covering an essential subject few investors handle right. So study it carefully. Common stock is just like any merchandise. You, as the merchant, must sell your stock if you're to realize a profit, and the best way to sell a stock is while it's on the way up, still advancing and looking strong to everyone.

This is completely contrary to human nature. It means selling when your stock is strong, up a lot in price, and looks like it will make even more profit for you. But when you sell like this, you won't be caught in heartrending 20% to 40% corrections that can hit market leaders and put downside pressure on your portfolio. You'll never sell at the top, so don't kick yourself when some stocks go higher after you sell.

If you don't sell early, you'll be late. Your object is to make and take significant gains and not get excited, optimistic, greedy, or emotionally carried away as your stock's advance gets stronger.

Keep in mind the old saying: "Bulls make money and bears make money, but pigs get slaughtered."

The basic objective of your account should be to show a net profit. To retain worthwhile profits, you must sell and take them. The key is knowing when to do just that.

Bernard Baruch, the financier who built a fortune in the stock market, said, "Repeatedly, I have sold a stock while it was still rising—and that has been one reason why I have held on to my fortune. Many a time, I might

have made a good deal more by holding a stock, but I would also have been caught in the fall when the price of the stock collapsed.”

When asked if there was a technique for making money on the stock exchange, Nathan Rothschild, the highly successful international banker, said, “There certainly is. I never buy at the bottom, and I always sell too soon.”

Joe Kennedy, one-time Wall Street speculator and father of popular former President John F. Kennedy, believed “only a fool holds out for the top dollar.” “The object,” he said, “is to get out while a stock is up before it has a chance to break and turn down.” And Gerald M. Loeb, a highly successful financier, stressed “once the price has risen into estimated normal or overvaluation areas, the amount held should be reduced steadily as quotations advance.”

What all these Wall Street legends believed was this: you simply must get out while the getting is good. The secret is to hop off the elevator on one of the floors on the way up and not ride it back down again.

You Must Develop a Profit-and-Loss Plan

To be a big success in the stock market, you must have definite rules and a profit-and-loss plan. I developed many of the buy and sell rules described in this book in the early 1960s, when I was a young stockbroker with Hayden, Stone. These rules helped me buy a seat on the New York Stock Exchange and start my own firm shortly thereafter. When I started out, though, I concentrated on developing a set of buy rules that would locate the very best stocks. But as you’ll see, I had only half of the puzzle figured out.

My buy rules were first developed in January 1960, when I analyzed the three best-performing mutual funds of the prior two years. The standout was the then-small Dreyfus Fund, which racked up gains twice as large as those of many of its competitors.

I sent for copies of every Dreyfus quarterly report and prospectus from 1957 to 1959. The prospectus showed the average cost of each new stock the fund purchased. Next, I got a book of stock charts and marked in red the average price Dreyfus paid for its new holdings each quarter.

After looking at more than a hundred new Dreyfus purchases, I made a stunning discovery: every stock had been bought at the highest price it had sold for in the past year. In other words, if a stock had bounced between \$40 and \$50 for many months, Dreyfus bought it as soon as it made a new high in price and traded between \$50 and \$51. The stocks had also formed certain chart price patterns before leaping into new high ground. This gave me two vitally important clues: buying on new highs from basing patterns was important, and certain chart patterns spelled big profit potential.

Jack Dreyfus Was a Chartist

Jack Dreyfus was a chartist and a tape reader. He bought all his stocks based on market action, and **only** when the price broke to new highs off sound chart patterns. He was also beating the pants off every competitor who ignored the real-world facts of market behavior (supply and demand) and depended only on fundamental, analytical personal opinions.

Jack's research department in those early, big-performance days consisted of three young Turks who posted the day's price and volume action of hundreds of listed stocks to very oversized charts. I saw these charts one day when I visited Dreyfus's headquarters in New York.

Shortly thereafter, two small funds run by Fidelity in Boston started doing the same thing. They, too, produced superior results. One was managed by Ned Johnson, Jr., and the other by Jerry Tsai. Almost all the stocks that the Dreyfus and Fidelity funds bought also had strong increases in their quarterly earnings reports.

So the first buy rules I made in 1960 were as follows:

1. Concentrate on listed stocks that sell for more than \$20 a share with at least some institutional acceptance.
2. Insist that the company show increases in earnings per share in each of the past five years and that the current quarterly earnings are up at least 20%.
3. Buy when the stock is making or about to make a new high in price after emerging from a sound correction and price consolidation period. This breakout should be accompanied by a volume increase to at least 50% above the stock's average daily volume.

The first stock I bought under my new set of buy rules was Universal Match in February 1960. It doubled in 16 weeks, but I failed to make much money because I didn't have much money to invest. I was just getting started as a stockbroker, and I didn't have many customers. I also got nervous and sold it too quickly. Later that year, sticking with my well-defined game plan, I selected Procter & Gamble, Reynolds Tobacco, and MGM. They, too, made outstanding price moves, but I still didn't make much money because the money I had to invest was limited.

About this time, I was accepted to Harvard Business School's first Program for Management Development (PMD). In what little extra time I had at Harvard, I read a number of business and investment books in the library. The best was *How to Trade in Stocks*, by Jesse Livermore. From this book, **I learned that your objective in the market was not to be right, but to make big money when you were right.**

Jesse Livermore and Pyramiding

After reading his book, I adopted Livermore's method of pyramiding, or averaging up, when a stock advanced after I purchased it. "Averaging up" is a technique where, after your initial stock purchase, you buy additional shares of the stock when it moves up in price. This is usually warranted when the first purchase of a stock is made precisely at a correct pivot, or buy, point and the price has increased 2% or 3% from the original purchase price. Essentially, I followed up what was working with additional but always *smaller* purchases, allowing me to concentrate my buying when I seemed to be right. If I was wrong and the stock dropped a certain amount below my cost, I sold the stock to cut short every loss.

This is very different from how the majority of people invest. Most of them average down, meaning they buy additional shares as a stock declines in price in order to lower their cost per share. But why add more of your hard-earned money to stocks that aren't working? That's a bad plan.

Learning by Analysis of My Failures

In the first half of 1961, my rules and plan worked great. Some of the top winners I bought that year were Great Western Financial, Brunswick, Kerr-McGee, Crown Cork & Seal, AMF, and Certain-teed. But by summer, all was not well.

I had bought the right stocks at exactly the right time and I had pyramided with several additional buys, so I had good positions and profits. But when the stocks finally topped, I held on too long and watched my profits vanish. If you've been investing for a while, I'll bet you know exactly what I'm talking about. It's a problem you must tackle and solve if you want real results. When you snooze, you lose. It was hard to swallow. I'd been dead right on my stock selections for more than a year, but I had just broken even.

I was so upset that I spent the last six months of 1961 carefully analyzing every transaction I had made during the prior year. Much like doctors do postmortem operations and the Civil Aeronautics Board conducts postcrash investigations, I took a red pen and marked on charts exactly where each buy and sell decision was made. Then I overlaid the general market averages.

Eventually my problem became crystal clear: I knew how to select the best leading stocks at the right time, but I had no plan for when to sell them and take profits. I had been completely clueless, a real dummy. I was so unaware that I had never even thought about when a stock should be sold and a profit taken. My stocks went up and then down like yo-yos, and my paper profits were wiped out.

For example, the way I handled Certain-teed, a building materials company that made shell homes, was especially poor. I bought the stock in the low \$20s, but during a weak moment in the market, I got scared and sold it for only a two- or three-point gain. Certain-teed went on to triple in price. I was in at the right time, but I didn't recognize what I had and failed to capitalize on a phenomenal opportunity.

My analysis of Certain-teed and other such personal failures proved to be the critical key to my seeing what I had been doing wrong that I had to correct if I was to get on the right track to future success. Have you ever analyzed every one of your failures so you can learn from them? Few people do. What a tragic mistake you'll make if you don't look carefully at yourself and the decisions you've made in the stock market that did not work. You get better only when you learn what you've done wrong.

This is the difference between winners and losers, whether in the market or in life. If you got hurt in the 2000 or 2008 bear market, don't get discouraged and quit. Plot out your mistakes on charts, study them, and write some additional new rules that, if you follow them, will correct your mistakes and let you avoid the actions that cost you a lot of time and money. You'll be that much closer to fully capitalizing on the next bull market. And in America, there will be many future bull markets. You're never a loser until you quit and give up or start blaming other people, like most politicians do. If you do what I've suggested here, it could just change your whole life.

"There are no secrets to success," said General Colin Powell, former secretary of state. "It is the result of preparation, hard work, and learning from failure."

My Revised Profit-and-Loss Plan

As a result of my analysis, I discovered that successful stocks, after breaking out of a proper base, tend to move up 20% to 25%. Then they usually decline, build new bases, and in some cases resume their advances. With this new knowledge in mind, I made a rule that I'd buy each stock exactly at the pivot buy point and have the discipline not to pyramid or add to my position at more than 5% past that point. Then I'd sell each stock when it was up 20%, while it was still advancing.

In the case of Certain-teed, however, the stock ran up 20% in just two weeks. This was the type of super winner I was hoping to find and capitalize on the next time around. So, I made an absolutely important exception to the "sell at +20% rule": if the stock was so powerful that it vaulted 20% in only one, two, or three weeks, it must be held for at least eight weeks from its buy point. Then it would be analyzed to see if it should be held for

a possible six-month long-term capital gain. (Six months was the long-term capital gains period at that time.) If a stock fell below its purchase price by 8%, I would sell it and take the loss.

So, here was the revised profit-and-loss plan: take 20% profits when you have them (except with the most powerful of all stocks) and cut your losses at a maximum of 8% below your purchase price.

The plan had several big advantages. You could be wrong twice and right once and still not get into financial trouble. When you were right and you wanted to follow up with another, somewhat smaller buy in the same stock a few points higher, you were frequently forced into a decision to sell one of your more laggard or weakest performers. The money in your slower-performing stock positions was continually force-fed into your best performers.

Over a period of years, I came to almost always make my first follow-up purchase automatically as soon as my initial buy was up 2% or 2½% in price. This lessened the chance I might hesitate and wind up making the additional buy when the stock was up 5% to 10% or not add at all.

When you appear to be right, you should always follow up. When a boxer in the ring finally has an opening and lands a powerful punch, he must always follow up his advantage . . . if he wants to win.

By selling your laggards and putting the proceeds into your winners, you are putting your money to far more efficient use. You could make two or three 20% plays in a good year, and you wouldn't have to sit through so many long, unproductive corrections while a stock built a whole new base.

A 20% gain in three to six months is substantially more productive than a 20% gain that takes 12 months to achieve. Two 20% gains compounded in one year equals a 44% annual rate of return. When you're more experienced, you can use full margin (buying power in a margin account), and increase your potential compounded return to nearly 100%.

How I Discovered the General Market System

Another exceedingly profitable observation made from analyzing every one of my money-losing, out-of-ignorance mistakes was that most of my market-leading stocks that topped had done so because the general market started into a decline of 10% or more. This conclusion finally led to my discovering and developing our system of interpreting the daily general market averages' price and volume chart. It gave us the critical ability to establish the true trend and major changes of direction in the overall market.

Three months later, by April 1, 1962, following all of my selling rules had automatically forced me out of every stock. I was 100% in cash, with no idea the market was headed for a real crash that spring. This is the fascinating

thing: the rules will force you out, but you don't know how bad it can really get. You just know it's going down and you're out, which sooner or later will be worth its weight in gold to you. That's what happened in 2008. Our rules forced us out, and we had no idea the market was headed for a major breakdown. Most institutional investors were affected because their investment policy was to be fully invested (95% to 100%).

In early 1962, I had finished reading *Reminiscences of a Stock Operator*, by Edwin LeFevre. I was struck by the parallels between the stock market panic of 1907, which LeFevre discussed in detail, and what seemed to be happening in April 1962. Since I was 100% in cash and my daily Dow analysis said the market was weak at that point, I began to sell short stocks such as Certain-teed and Alside (an earlier sympathy play to Certain-teed). For this, I got into trouble with Hayden, Stone's home office on Wall Street. The firm had just recommended Certain-teed as a buy, and here I was going around telling everyone it was a short sale. Later in the year, I sold Korvette short at over \$40. The profits from both of these short sales were good.

By October 1962, during the Cuban missile crisis, I was again in cash. A day or two after the Soviet Union backed down from President Kennedy's wise naval blockade, a rally attempt in the Dow Jones Industrial Average followed through, signaling a major upturn according to my new system. I then bought the first stock of the new bull market, Chrysler, at 58%. It had a classic cup-with-handle base.

Throughout 1963, I simply followed my rules to the letter. They worked so well that the "worst"-performing account I managed that year was up 115%. It was a cash account. Other accounts that used margin were up several hundred percent. There were many individual stock losses, but they were usually small, averaging 5% to 6%. Profits, on the other hand, were awesome because of the concentrated positions we built by careful, disciplined pyramiding when we were right.

Starting with only \$4,000 or \$5,000 that I had saved from my salary, plus some borrowed money and the use of full margin, I had three back-to-back big winners: Korvette on the short side in late 1962, Chrysler on the buy side, and Syntex, which was bought at \$100 per share with the Chrysler profit in June 1963. After eight weeks, Syntex was up 40%, and I decided to play this powerful stock out for six months. By the fall of 1963, the profit had topped \$200,000, and I decided to buy a seat on the New York Stock Exchange. So don't ever let anyone tell you it can't be done! **You can learn to invest wisely if you're willing to study all of your mistakes, learn from them, and write new self-correcting rules.** This can be the greatest opportunity of a lifetime, if you are determined, not easily discouraged, and willing to work hard and prepare yourself. Anyone can make it happen.

For me, many long evenings of study led to precise rules, disciplines, and a plan that finally worked. Luck had nothing to do with it; it was persistence and hard work. You can't expect to watch television, drink beer, or party with your friends every night and still find the answers to something as complicated as the stock market or the U.S. economy.

In America, anyone can do anything by working at it. There are no limits placed on you. It all depends on your desire and your attitude. It makes no difference where you're from, what you look like, or where you went to school. You can improve your life and your future and capture the American Dream. And you don't have to have a lot of money to start.

If you get discouraged at times, don't ever give up. Go back and put in some detailed extra effort. It's always the study and learning time that you put in *after* nine to five, Monday through Friday, that ultimately makes the difference between winning and reaching your goals, and missing out on truly great opportunities that really can change your whole life.

Two Things to Remember about Selling

Before we examine the key selling rules one by one, keep these two key points in mind.

First, buying precisely right solves most of your selling problems. If you buy at exactly the right time off a proper daily or weekly chart base in the first place, and you do not chase or pyramid a stock when it's extended in price more than 5% past a correct pivot buy point, you will be in a position to sit through most normal corrections. Winning stocks very rarely drop 8% below a correct pivot buy point. In fact, most big winners don't close below their pivot point. Buying as close to the pivot point as possible is therefore absolutely essential and may let you cut the smaller number of resulting losses more quickly than 8%. A stock might have to drop only 4% or 5% before you know something could be wrong.

Second, beware of the big-block selling you might see on a ticker tape or your PC just after you buy a stock during a bull market. The selling might be emotional, uninformed, temporary, or not as large (relative to past volume) as it appears. The best stocks can have sharp sell-offs for a few days or a week. Consult a weekly basis stock chart for an overall perspective to avoid getting scared or shaken out in what may just be a normal pullback. In fact, 40% to 60% of the time, a winning stock may pull back to its exact buy point or slightly below and try to shake you out. But it should not be down 8% unless you chased it too high in price when you bought it. If you're making too many mistakes and nothing seems to be working for you, check and make sure you're

not making a number of your buys 10%, 15%, or 20% above the precise, correct buy point. Chasing stocks rarely works. You can't buy when you get more excited. **So stop chasing extended stocks.**

Technical Sell Signs

By studying how the greatest stock market winners, as well as the market itself, all topped, I came up with the following list of factors that occur when a stock tops and rolls over. Perhaps you've noticed that few of the selling rules involve changes in the fundamentals of a stock. Many big investors get out of a stock before trouble appears on the income statement. If the smart money is selling, so should you. Individual investors don't stand much chance when institutions begin liquidating large positions. You buy with heavy emphasis on the fundamentals, such as earnings, sales, profit margins, return on equity, and new products, but many stocks peak when earnings are up 100% and analysts are projecting continued growth and higher price targets.

On the same day in 1999 that I sold Charles Schwab stock on a climax top run-up and an exhaustion gap, one of the largest brokerage firms in America projected that the stock would go up 50 points more. Virtually all of my successful stocks were sold on the way up, while they were advancing and the market was not affected. A bird in the hand is worth two imaginary ones in the bush. Therefore, you must frequently sell based on unusual market action (price and volume movement), not personal opinions from Wall Street. You must wean yourself from listening to personal opinions. Since I never worked on Wall Street, I never got distracted by these diversions.

There are many signals to look for when you're trying to recognize when a stock could be in a topping process. These include the price movement surrounding climax tops, adverse volume, and other weak action. A lot of this will become clearer to you as you continue to study this information and apply it to your daily decision making. These rules and principles have been responsible for most of my better decisions in the market, but they can seem a bit complicated at first. I suggest that you reread Chapter 2 on chart reading, then read these selling rules again.

In fact, most of the IBD subscribers I've met at our hundreds of workshops who have enjoyed real success with their investments have told me that they read this entire book two or three times, or even more. You probably aren't going to get it all in one reading. Some who have been distracted by all the outside noise say that they read it periodically to help them get back on the right track.

Climax Tops

Many leading stocks top in an explosive fashion. They make climax runs—suddenly advancing at a much faster rate for one or two weeks after an advance of many months. In addition, they often end in exhaustion gaps—when a stock's price opens up on a gap from the prior day's close, on heavy volume. These and related bull market climax signals are discussed in detail here.

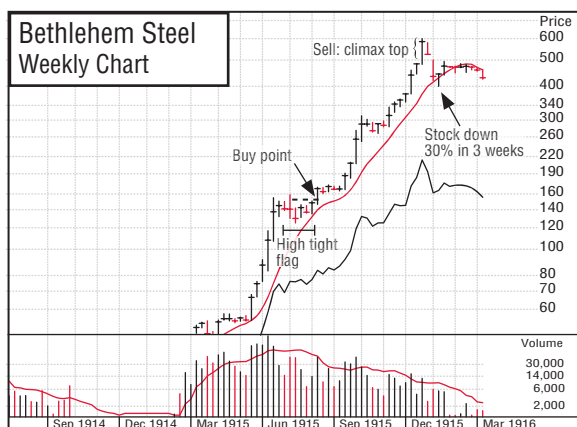
- 1. Largest daily price run-up.** If a stock's price is extended—that is, if it's had a significant run-up for many months from its buy point off a sound and proper base—and it closes for the day with a larger price increase than on any previous up day since the beginning of the whole move up, watch out! This usually occurs very close to a stock's peak.
- 2. Heaviest daily volume.** The ultimate top might occur on the heaviest volume day since the beginning of the advance.
- 3. Exhaustion gap.** If a stock that's been advancing rapidly is greatly extended from its original base many months ago (usually at least 18 weeks out of a first- or second-stage base and 12 weeks or more if it's out of a later-stage base) and then opens on a gap up in price from the previous day's close, the advance is near its peak. For example, a two-point gap in a stock's price after a long run-up would occur if it closed at its high of \$50 for the day, then opened the next morning at \$52 and held above \$52 during the day. This is called an exhaustion gap.
- 4. Climax top activity.** Sell if a stock's advance gets so active that it has a rapid price run-up for two or three weeks on a weekly chart, or for seven of eight days in a row or eight of ten days on a daily chart. This is called a climax top. The price spread from the stock's low to its high for the week will almost always be greater than that for any prior week since the beginning of the original move many months ago.

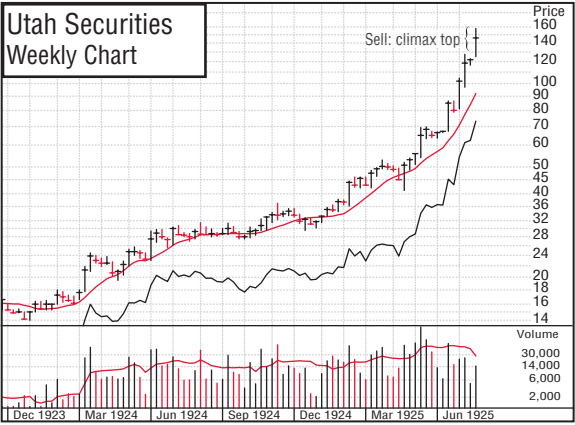
In a few cases, around the top of a climax run, a stock may retrace the prior week's large price spread from the prior week's low to its high point and close the week up a little, with volume remaining very high. I call this “railroad tracks” because on a weekly chart, you'll see two parallel vertical lines. This is a sign of continued heavy volume distribution without real additional price progress for the week.

- 5. Signs of distribution.** After a long advance, heavy daily volume without further upside price progress signals distribution. Sell your stock before unsuspecting buyers are overwhelmed. Also know when savvy investors are due to have a long-term capital gain.
- 6. Stock splits.** Sell if a stock runs up 25% to 50% for one or two weeks on a stock split. In a few rare cases, such as Qualcomm at the end of

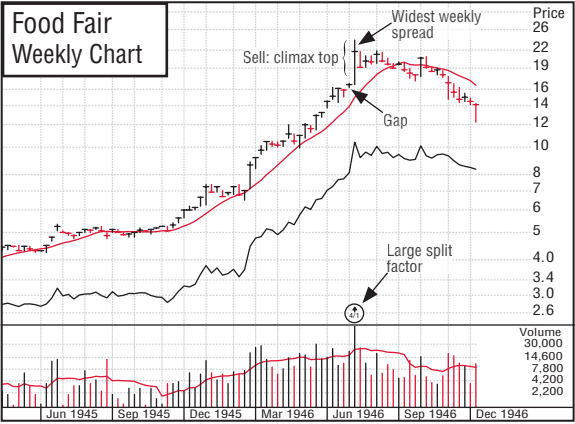
1999, it could be 100%. Stocks tend to top around excessive stock splits. If a stock's price is extended from its base and a stock split is announced, in many cases the stock could be sold.

- 7. Increase in consecutive down days.** For most stocks, the number of consecutive down days in price relative to up days in price will probably increase when the stock starts down from its top. You may see four or five days down, followed by two or three days up, whereas before you would have seen four days up and then two or three down.
- 8. Upper channel line.** You should sell if a stock goes through its upper channel line after a huge run-up. (On a stock chart, channel lines are somewhat parallel lines drawn by connecting the lows of the price pattern with one straight line and then connecting three high points made over the past four to five months with another straight line.) Studies show that stocks that surge above their *properly drawn* upper channel lines should be sold.
- 9. 200-day moving average line.** Some stocks may be sold when they are 70% to 100% or more above their 200-day moving average price line, although I have rarely used this one.
- 10. Selling on the way down from the top.** If you didn't sell early while the stock was still advancing, sell on the way down from the peak. After the first breakdown, some stocks may pull back up in price once.

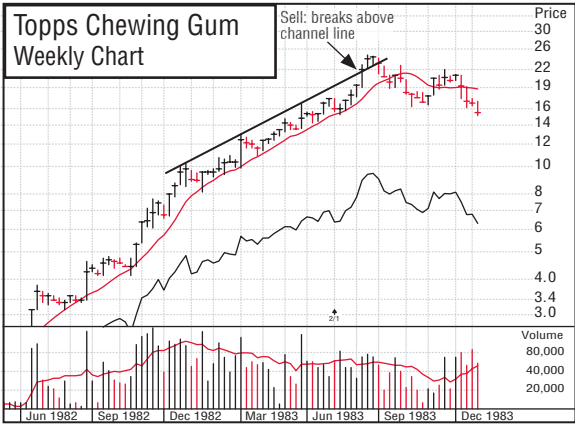




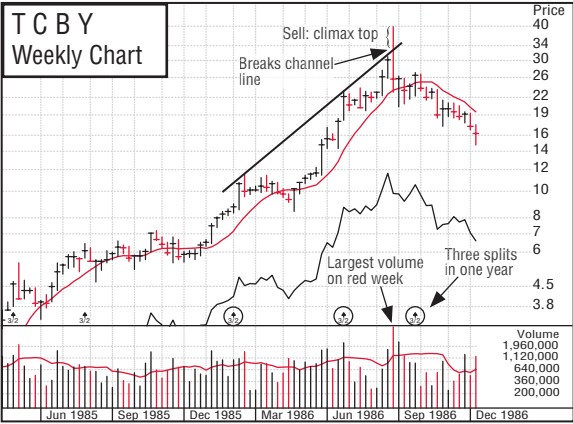
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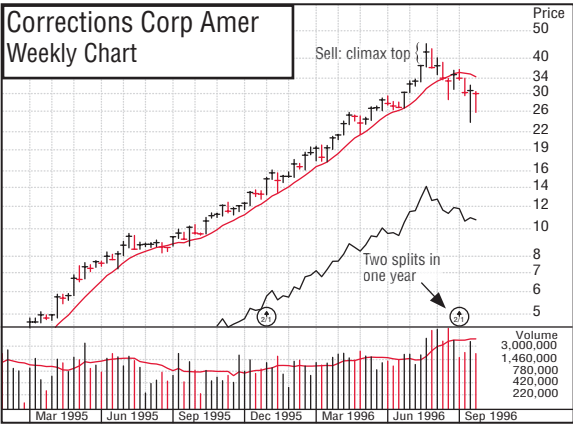
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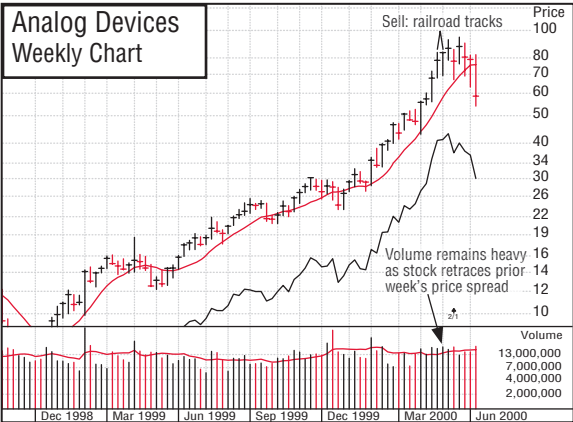
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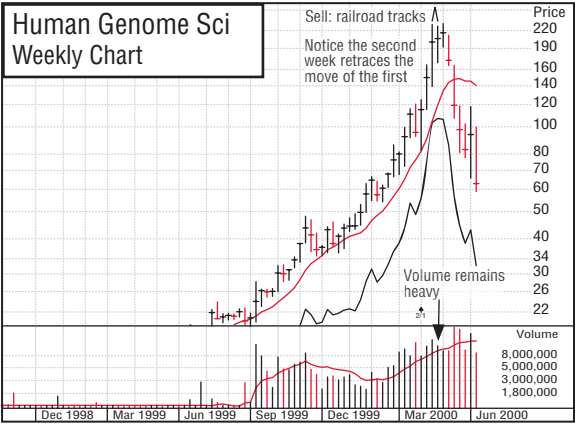
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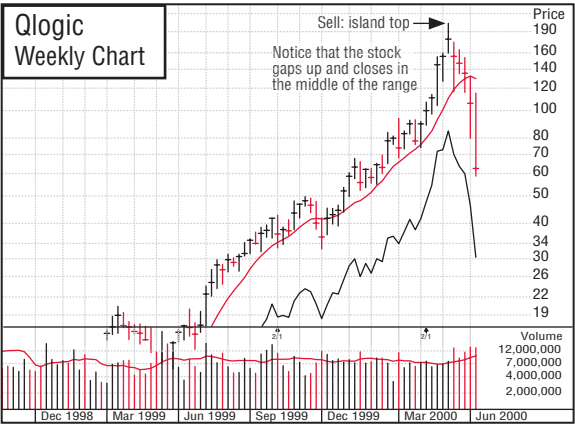
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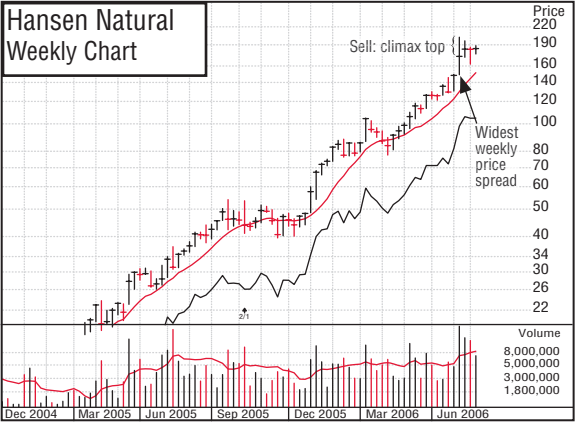
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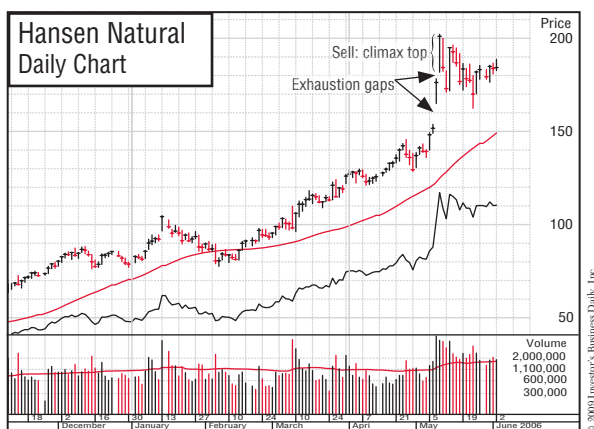
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Low Volume and Other Weak Action

- 1. New highs on low volume.** Some stocks will make new highs on lower or poor volume. As the stock goes higher, volume trends lower, suggesting that big investors have lost their appetite for the stock.
- 2. Closing at or near the day's price low.** Tops can also be seen on a stock's daily chart in the form of "arrows" pointing down. That is, for several days, the stock will close at or near the low of the daily price range, fully retracing the day's advance.
- 3. Third- or fourth-stage bases.** Sell when your stock makes a new high in price off a third- or fourth-stage base. The third time is seldom a charm in the market. By then, an advancing stock has become too obvious, and almost everyone sees it. These late-stage base patterns are often faulty, appearing wider and looser. As much as 80% of fourth-stage bases should fail, but you have to be right in determining that this is a fourth-stage base.
- 4. Signs of a poor rally.** When you see initial heavy selling near the top, the next recovery will follow through weaker in volume, show poor price recovery, or last fewer days. Sell on the second or third day of a poor rally; it may be the last good chance to sell before trend lines and support areas are broken.
- 5. Decline from the peak.** After a stock declines 8% or so from its peak, in some cases examination of the previous run-up, the top, and the decline may help you determine whether the advance is over or whether a normal 8% to 15% correction is in progress. You may occasionally want to sell if a decline from the peak exceeds 12% or 15%.

6. **Poor relative strength.** Poor relative price strength can be another reason for selling. Consider selling when a stock's IBD's Relative Price Strength Rating drops below 70.
7. **Lone Ranger.** Consider selling if there is no confirming price strength by any other important member of the same industry group.

Breaking Support

Breaking support occurs when stocks close for the week below established major trend lines.

1. **Long-term uptrend line is broken.** Sell if a stock closes at the end of the week below a major long-term uptrend line or breaks a key price support area on *overwhelming* volume. An uptrend line should connect at least three intraday or intraweek price lows occurring over a number of months. Trend lines drawn over too short a time period aren't valid.
2. **Greatest one-day price drop.** If a stock has already made an extended advance and suddenly makes its greatest one-day price drop since the beginning of the move, consider selling if the move is confirmed by other signals.
3. **Falling price on heavy weekly volume.** In some cases, sell if a stock breaks down on the largest weekly volume in its prior several years.
4. **200-day moving average line turns down.** After a prolonged upswing, if a stock's 200-day moving average price line turns down, consider selling the stock. Also, sell on new highs if a stock has a weak base with much of the price work in the lower half of the base or below the 200-day moving average price line.
5. **Living below the 10-week moving average.** Consider selling if a stock has a long advance, then closes below its 10-week moving average and lives below that average for eight or nine consecutive weeks, unable to rally and close the week above the line.

Other Prime Selling Pointers

1. If you cut all your losses at 7% or 8%, take a few profits when you're up 20%, 25%, or 30%. Compounding three gains like this could give you an overall gain of 100% or more. However, don't sell and take a 25% or 30% gain in any market leader with institutional support that's run up 20% in only one, two, or three weeks from the pivot buy point on a proper base. Those could be your big leaders and should be held for a potentially greater profit.

2. If you're in a bear market, get off margin, raise more cash, and don't buy very many stocks. If you do buy, maybe you should take 15% profits and cut all your losses at 3%.
3. In order to sell, big investors must have buyers to absorb their stock. Therefore, consider selling if a stock runs up and then good news or major publicity (a cover article in *BusinessWeek*, for example) is released.
4. Sell when there's a great deal of excitement about a stock and it's obvious to everyone that the stock is going higher. By then it's too late. Jack Dreyfus said, "Sell when there is an *overabundance* of optimism. When everyone is bubbling over with optimism and running around trying to get everyone else to buy, they are fully invested. At this point, all they can do is talk. They can't push the market up anymore. It takes buying power to do that." Buy when you're scared to death and others are unsure. Wait until you're happy and tickled to death to sell.
5. In most cases, sell when the percentage increases in quarterly earnings slow materially (or by two-thirds from the prior rate of increase) for two consecutive quarters.
6. Be careful of selling on bad news or rumors; they may be of temporary influence. Rumors are sometimes started to scare individual investors—the little fish—out of their holdings.
7. Always learn from all your past selling mistakes. Do your own postanalysis by plotting your past buy and sell points on charts. Study your mistakes carefully, and write down additional rules to avoid past mistakes that caused excessive losses or big missed opportunities. That's how you become a savvy investor.

When to Be Patient and Hold a Stock

Closely related to the decision on when to sell is when to sit tight. Here are some suggestions for doing just that.

Buy growth stocks where you can project a potential price target based on earnings estimates for the next year or two and possible P/E expansion from the stock's original base breakout. Your objective is to buy the best stock with the best earnings at exactly the right time and to have the patience to hold it until you have been proven right or wrong.

In a few cases, you may have to allow 13 weeks after your first purchase before you conclude that a stock that hasn't moved is a dull, faulty selection. This, of course, applies only if the stock did not reach your defensive, loss-cutting sell price first. In a fast-paced market, like the one in 1999, tech stocks that didn't move after several weeks while the general market was ral-

lying could have been sold earlier, and the money moved into other stocks that were breaking out of sound bases with top fundamentals.

When your hard-earned money is on the line, it's more important than ever to pay attention to the general market and check IBD's "The Big Picture" column, which analyzes the market averages. In both the 2000 top and the top in the 2007–2008 market, "The Big Picture" column and our sell rules got many subscribers out of the market and helped them dodge devastating declines.

If you make new purchases when the market averages are under distribution, topping, and starting to reverse direction, you'll have trouble holding the stocks you've bought. (Most breakouts will fail, and most stocks will go down, so stay in phase with the general market. Don't argue with a declining market.)

After a new purchase, draw a defensive sell line in red on a daily or weekly graph at the precise price level at which you will sell and cut your loss (8% or less below your buy point). In the first one to two years of a new bull market, you may want to give stocks this much room on the downside and hold them until the price touches the sell line before selling.

In some instances, the sell line may be raised but kept below the low of the first normal correction after your initial purchase. If you raise your loss-cutting sell point, don't move it up too close to the current price. This will keep you from being shaken out during any normal weakness.

You definitely shouldn't continue to follow a stock up by raising stop-loss orders because you will be forced out near the low of an inevitable, natural correction. Once your stock is 15% or more above your purchase price, you can begin to concentrate on the price where or under what rules you will sell it on the way up to nail down your profit.

Any stock that rises close to 20% should never be allowed to drop back into the loss column. If you buy a stock at \$50 and it shoots up to \$60 (+20%) or more, even if you don't take the profit when you have it, there's no intelligent reason to ever let the stock drop all the way back to \$50 or below and create a loss. You may feel embarrassed, ridiculous, and not too bright if you buy at \$50, watch the stock hit \$60, and then sell at \$50 to \$51. But you've already made the mistake of not taking your profit. Now avoid making a second mistake by letting it develop into a loss. Remember, one important objective is to keep all your losses as small as possible.

Also, major advances require time to complete. Don't take profits during the first eight weeks of a move unless the stock gets into serious trouble or is having a two- or three-week "climax" run-up on a stock split in a late-stage base. Stocks that show a 20% profit in less than eight weeks should be held through the eight weeks unless they are of poor quality without institutional

sponsorship or strong group action. In many cases, stocks that advance dramatically by 20% or more in only one to four weeks are the most powerful stocks of all—capable of doubling, tripling, or more. If you own one of these true CAN SLIM market leaders, try to hold it through the first couple of times it pulls back in price to, or slightly below, its 10-week moving average price line. Once you have a decent profit, you could also try to hold the stock through its first short-term correction of 10% to 20%.

When a stock breaks out of a proper base, after its first move up, 80% of the time it will pull back somewhere between its second and its sixth week out of the base. Holding for eight weeks, of course, gets you through this first selling squall and into a resumed uptrend, and you'll then have a better profit cushion.

Remember, your objective is not just to be right but to make big money when you are right. "It never is your thinking that makes big money," said Livermore. "It's the sitting." Investors who can be right and sit tight are rare. It takes time for a stock to make a large gain.

The first two years of a new bull market typically provide your best and safest period, but they require courage, patience, and profitable sitting. If you really know and understand a company thoroughly and its products well, you'll have the crucial additional confidence required to sit tight through several inevitable but normal corrections. Achieving giant profits in a stock takes time and patience and following rules.

You've just read one of the most valuable chapters in this book. If you review it several times and adopt a disciplined profit-and-loss plan for your own investments, it could be worth several thousand times what you paid for this book. You might even make a point of rereading this chapter once every year.

You can't become a big winner in the stock market until you learn to be a good seller as well as a good buyer. Readers who followed these historically proven sell rules during 2000 nailed down most of the substantial gains they made in 1998 and 1999. A few serious students made 500% or more during that fast-moving period. Again in 2008, an even greater percentage of *Investor's Business Daily* readers, although not every one, after much work and study were able to implement proper selling rules to protect and preserve their hard-earned capital rather than succumb to the dramatic declines in the year's third and fourth quarters.

12

• CHAPTER •

Money Management: Should You Diversify, Invest for the Long Haul, Use Margin, Sell Short, or Buy Options, IPOs, Tax Shelters, Nasdaq Stocks, Foreign Stocks, Bonds, or Other Assets?

Once you have decided to participate in the stock market, you are faced with more decisions than just which stock to purchase. You have to decide how you will handle your portfolio, how many stocks you should buy, what types of actions you will take, and what types of investments are better left alone.

This and the following chapter will introduce you to the many options and alluring diversions you have at your disposal. Some of them are beneficial and worthy of your attention, but many others are overly risky, extremely complicated, or unnecessarily distracting and less rewarding. Regardless, it helps to be informed and to know as much about the investing business as possible—if for no other reason than to know all the things you should avoid. I say don't make it too complicated; keep it simple.

How Many Stocks Should You Really Own?

How many times have you been told, “Don't put all your eggs in one basket”? On the surface, this sounds like good advice, but my experience is that few people do more than one or two things exceedingly well. Those who are jacks-of-all-trades and masters of none are rarely dramatically successful in

any field, including investing. Did all the esoteric derivatives help or harm Wall Street pros? Did experimenting with highly abnormal leverage of 50 or 100 to 1 help or hurt them?

Would you go to a dentist who did a little engineering or cabinetmaking on the side and who, on weekends, wrote music and worked as an auto mechanic, plumber, and accountant?

This is true of companies as well as people. The best example of diversification in the corporate world is the conglomerate. Most large conglomerates do not do well. They're too big, too inefficient, and too spread out over too many businesses to focus effectively and grow profitably. Whatever happened to Jimmy Ling and Ling-Temco-Vought or to Gulf+Western Industries after the conglomerate craze of the late 1960s collapsed? Big business and big government in America can both become inefficient, make many mistakes, and create nearly as many big new problems as they hope to solve.

Do you remember when Mobil Oil diversified into the retail business by acquiring Montgomery Ward, the struggling national department-store chain, years ago? It never worked. Neither did Sears, Roebuck's move into financial services with the purchases of Dean Witter and Coldwell Banker, or General Motors's takeover of computer-services giant EDS, or hundreds of other corporate diversification attempts. How many different businesses and types of loans was New York's Citigroup involved in from 2000 to 2008?

The more you diversify, the less you know about any one area. Many investors overdiversify. The best results are usually achieved through concentration, by putting your eggs in a few baskets that you know well and watching them very carefully. Did broad diversification protect your portfolio in the 2000 break or in 2008? The more stocks you own, the slower you may be to react and take selling action to raise sufficient cash when a serious bear market begins, because of a false sense of security. When major market tops occur, you should sell, get off margin if you use borrowed money, and raise at least some cash. Otherwise, you'll give back most of your gains.

The winning investor's objective should be to have one or two big winners rather than dozens of very small profits. It's much better to have a number of small losses and a few very big profits. Broad diversification is plainly and simply often a hedge for ignorance. Did all the banks from 1997 to 2007 that bought packages containing 5,000 widely diversified different real estate loans that had the implied backing of the government and were labeled triple A protect and grow their investments?

Most people with \$20,000 to \$200,000 to invest should consider limiting themselves to four or five carefully chosen stocks they know and understand. Once you own five stocks and a tempting situation comes along that you want to buy, you should muster the discipline to sell your least attractive

investment. If you have \$5,000 to \$20,000 to invest, three stocks might be a reasonable maximum. A \$3,000 account could be confined to two equities. Keep things manageable. The more stocks you own, the harder it is to keep track of all of them. Even investors with portfolios of more than a million dollars need not own more than six or seven well-selected securities. If you're uncomfortable and nervous with only six or seven, then own ten. But owning 30 or 40 could be a problem. The big money is made by concentration, provided you use sound buy and sell rules along with realistic general market rules. And there certainly is no rule that says that a 50-stock portfolio can't go down 50% or more.

How to Spread Your Purchases over Time

It's possible to spread out your purchases over a period of time. This is an interesting form of diversifying. When I accumulated a position in Amgen in 1990 and 1991, I bought on numerous days. I spread out the buying and made add-on buys only when there was a significant gain on earlier buys. If the market price was 20 points over my average cost and a new buy point occurred off a proper base, I bought more, but I made sure not to run my average cost up by buying more than a limited or moderate addition.

However, newcomers should be extremely careful in trying this more risky, highly concentrated approach. You have to learn how to do it right, and you positively have to sell or cut back if things don't work as expected.

In a bull market, one way to maneuver your portfolio toward more concentrated positions is to follow up your initial buy and make one or two smaller additional buys in stocks as soon as they have advanced 2% to 3% above your initial buy. However, don't allow yourself to keep chasing a stock once it's extended too far past a correct buy point. This will also spare you the frustration of owning a stock that goes a lot higher but isn't doing your portfolio much good because you own fewer shares of it than you do of your other, less-successful issues. At the same time, sell and eliminate stocks that start to show losses before they become big losses.

Using this follow-up purchasing procedure should keep more of your money in just a few of your best stock investments. No system is perfect, but this one is more realistic than a haphazardly diversified portfolio and has a better chance of achieving important results. Diversification is definitely sound; just don't overdo it. *Always set a limit on how many stocks you will own, and stick to your rules.* Always keep your set of rules with you—in a simple notebook, perhaps—when you're investing. What? You say you've been investing without any specific buy or sell rules? What results has that produced for you over the last five or ten years?

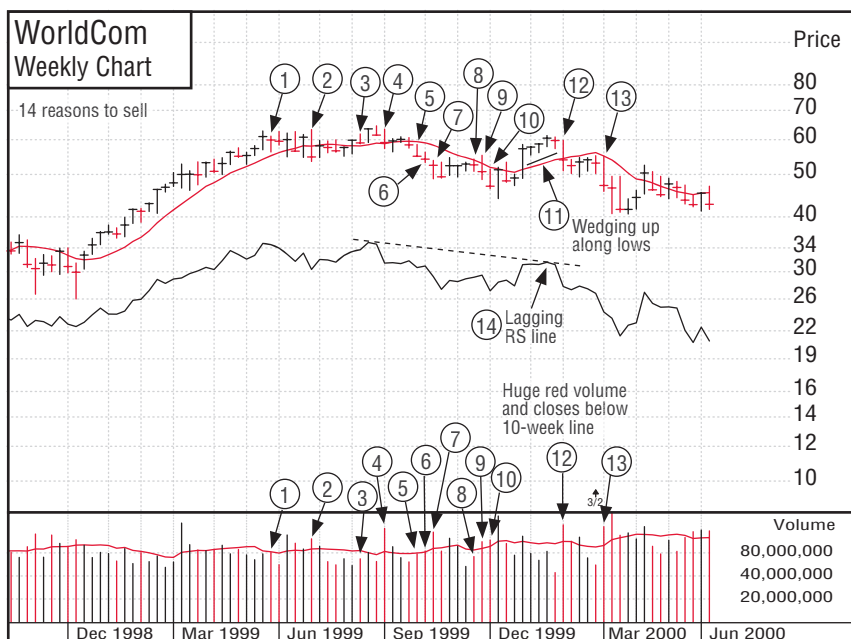
Should You Invest for the Long Haul?

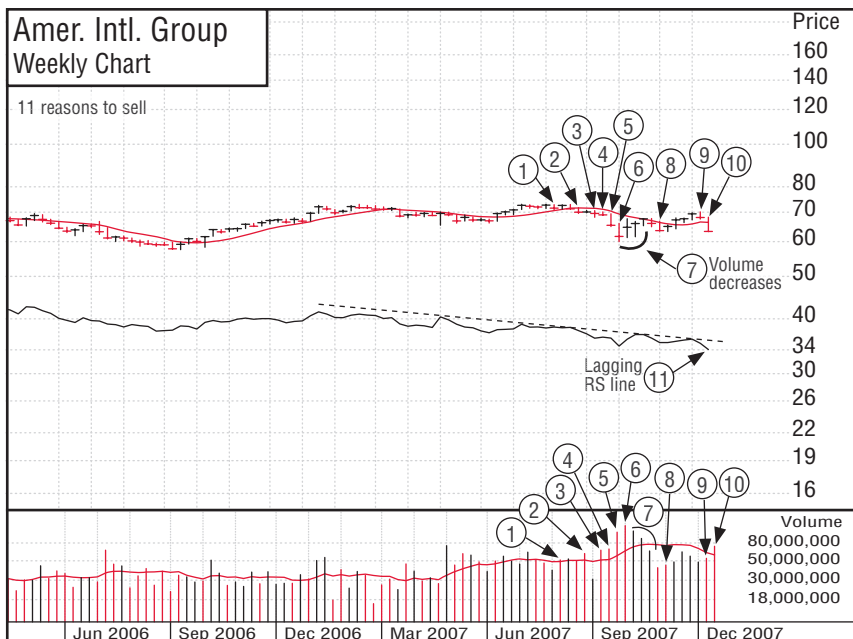
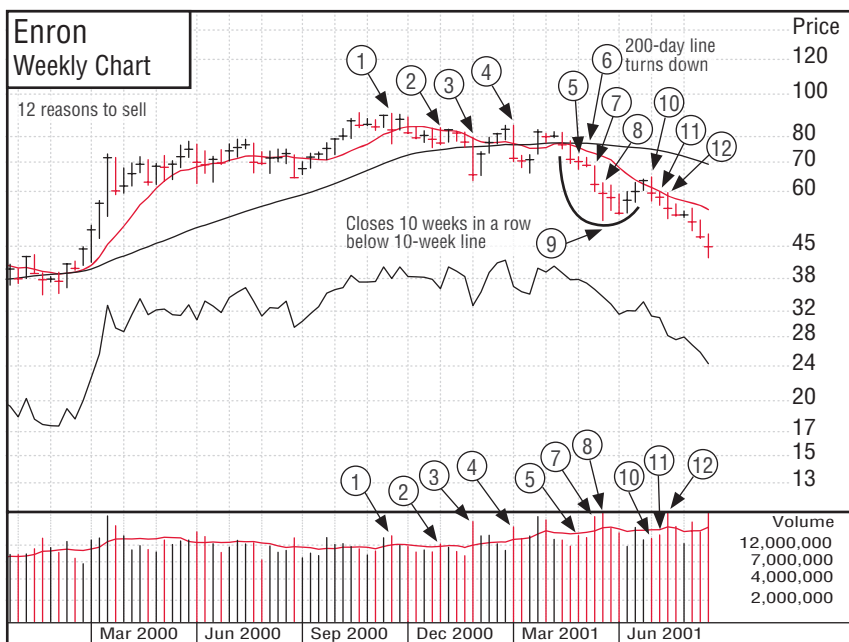
If you do decide to concentrate, should you invest for the long haul or trade more frequently? The answer is that the holding period (long or short) is not the main issue. What's critical is buying the right stock—the very best stock—at precisely the right time, then selling it whenever the market or your various sell rules tell you it's time to sell. The time between your buy and your sell could be either short or long. Let your rules and the market decide which one it is. If you do this, some of your winners will be held for three months, some for six months, and a few for one, two, or three years or more. Most of your losers will be held for much shorter periods, normally between a few weeks and three months. No well-run portfolio should ever, ever have losses carried for six months or more. Keep your portfolio clean and in sync with the market. Remember, good gardeners always weed the flower patch and prune weak stems.

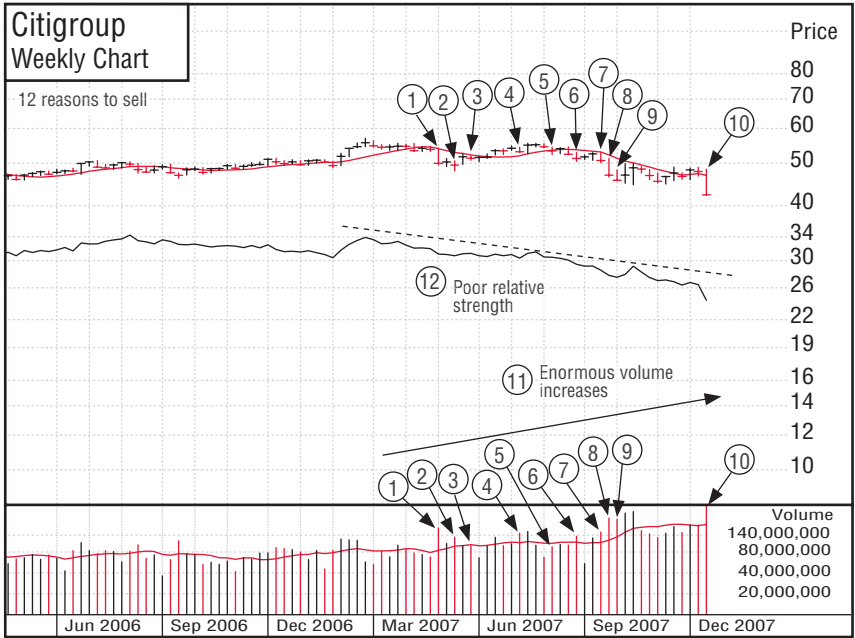
Lessons for Buy-and-Hold Investors Who Don't Use Charts

I've marked up the weekly charts of WorldCom in 1999, Enron in 2001, and AIG, Citigroup, and General Motors in 2007. They show 10 to 15 specific signs that these investments should clearly have been sold at that time.

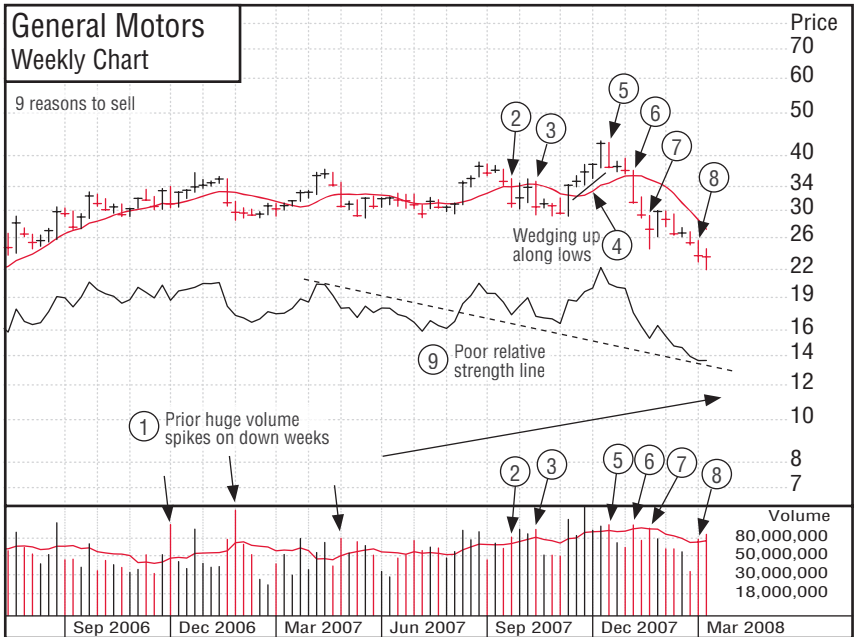
Why you must always use charts...see what happens next.



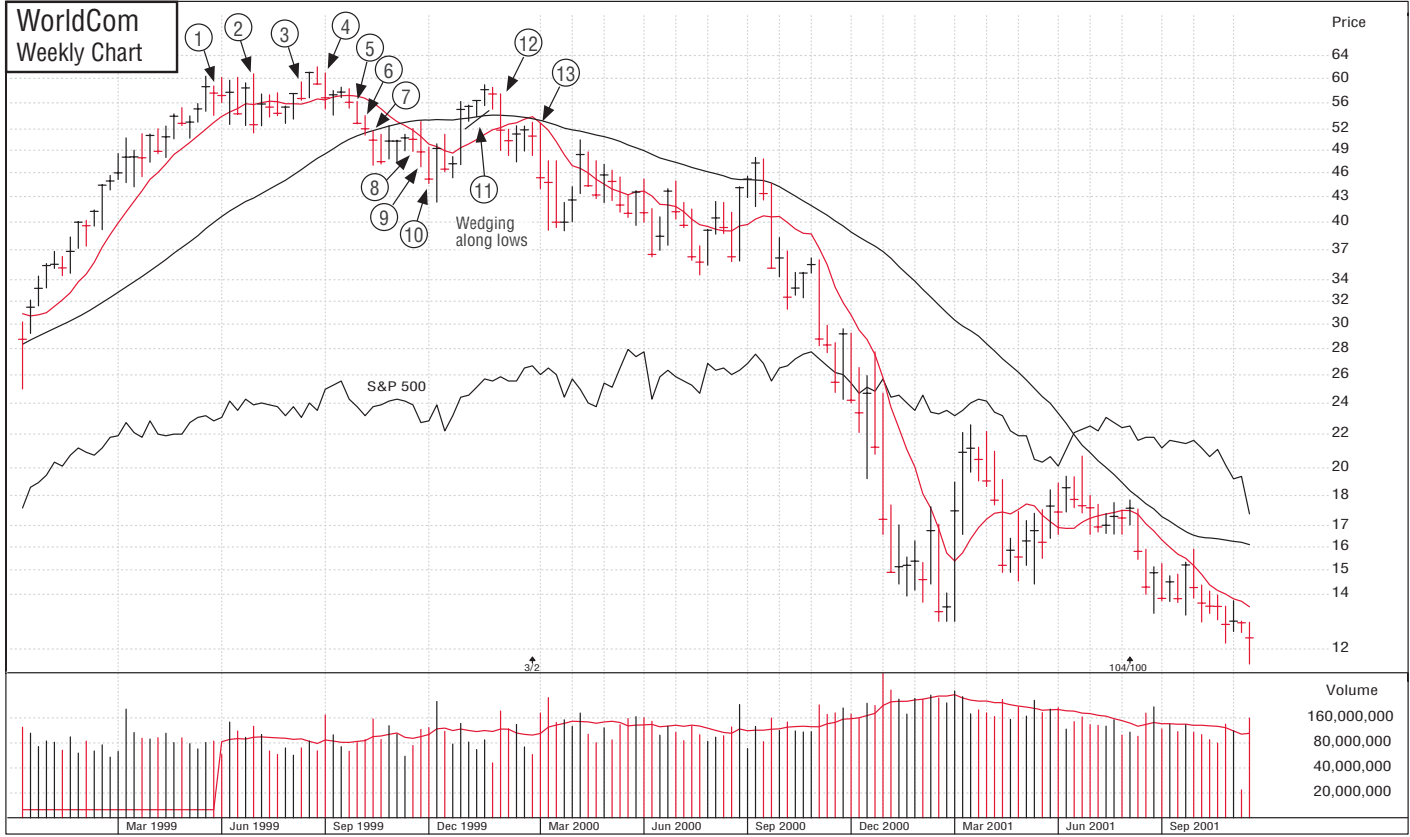




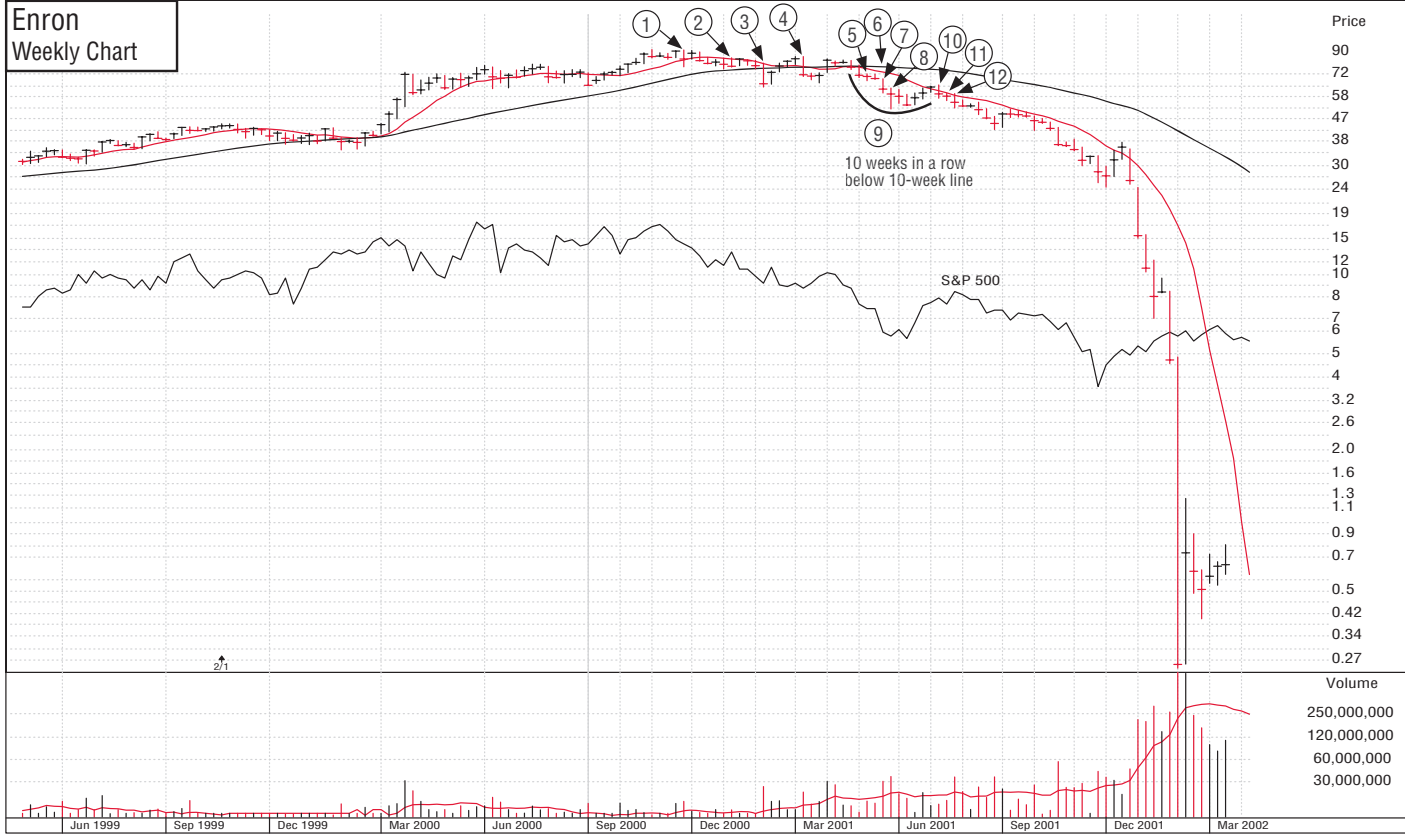
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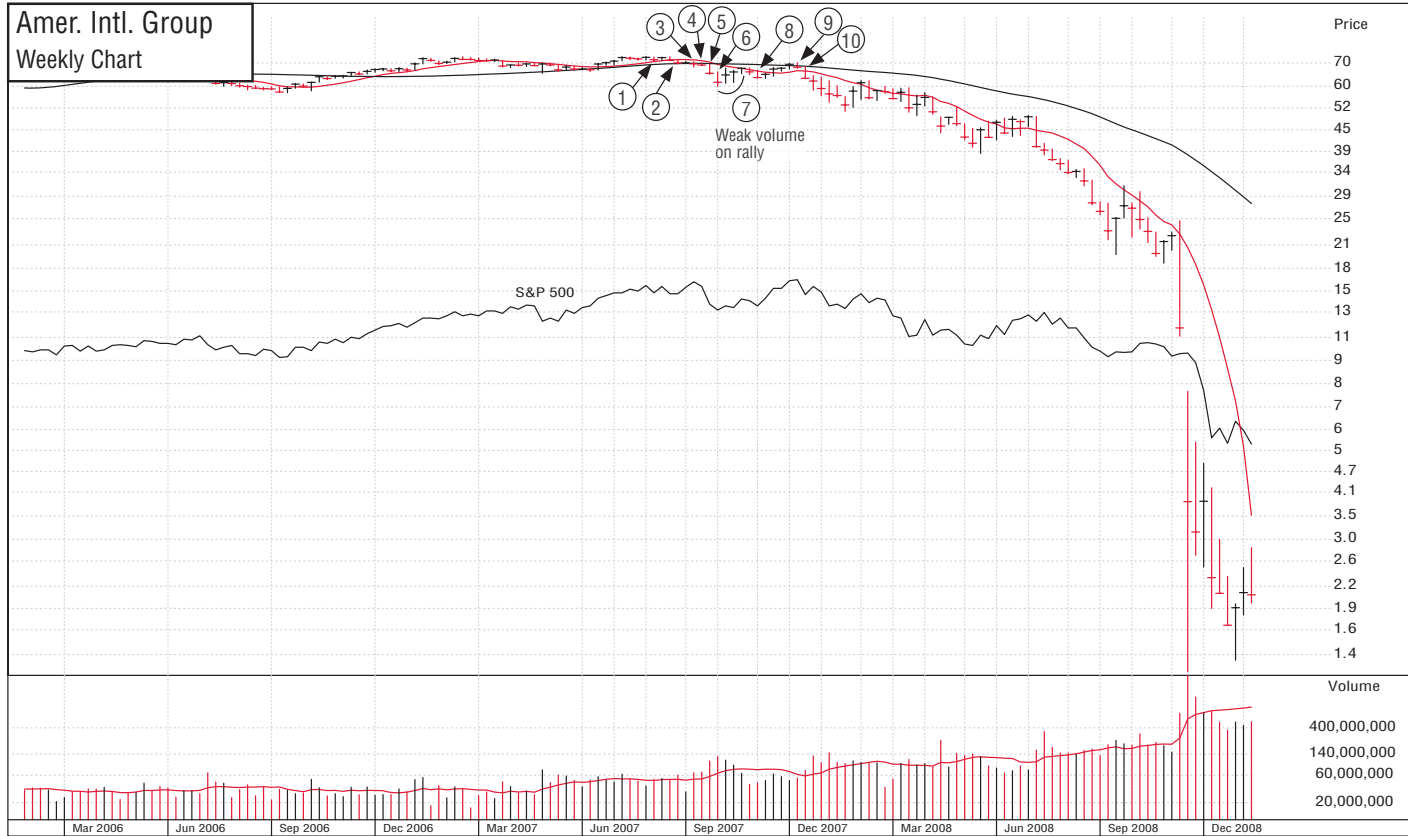


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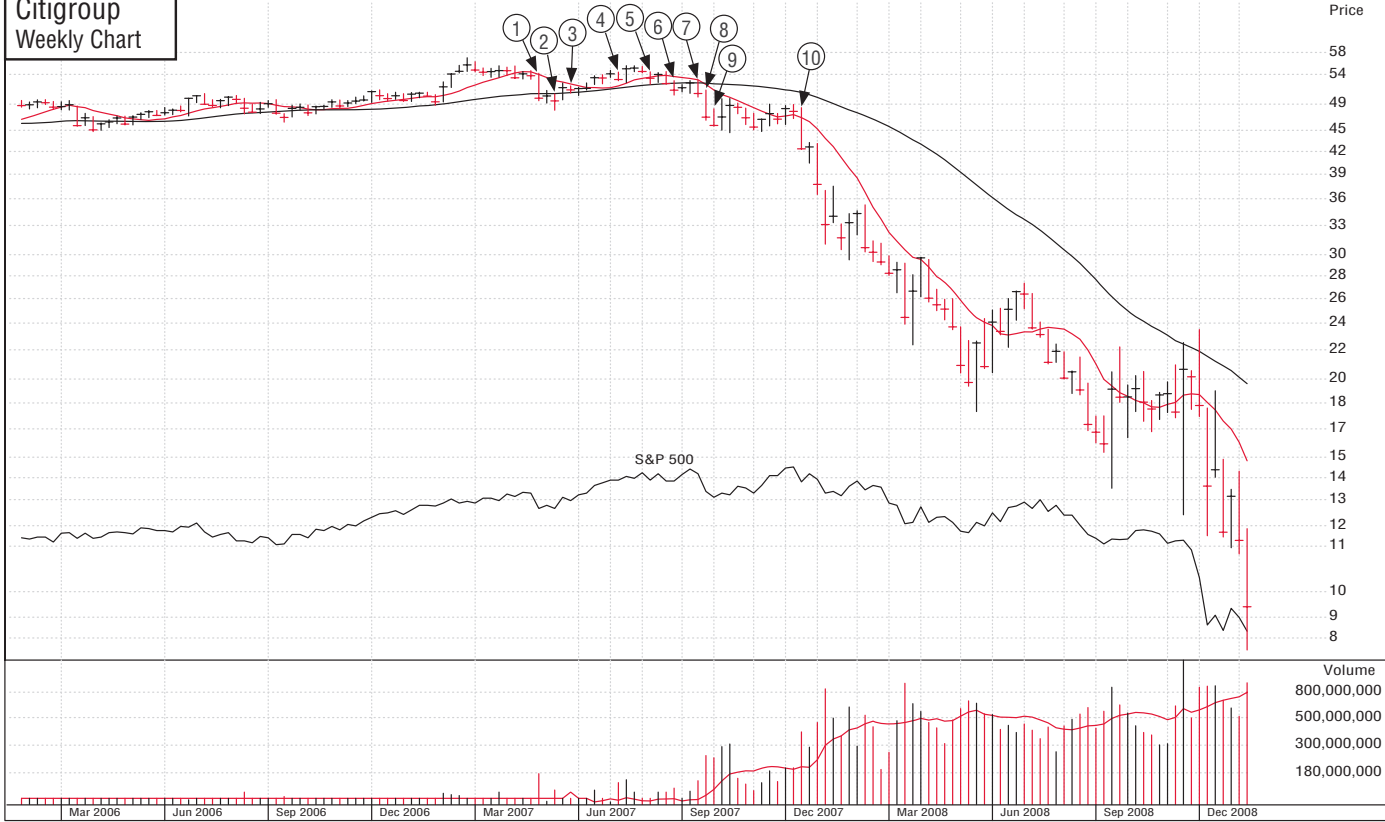


Enron Weekly Chart





Citigroup Weekly Chart



General Motors Weekly Chart



Actually, if you looked at a longer time period, there were even more sell signals. For example, Citigroup had dramatically underperformed on a relative strength basis for the prior three years, from 2004 through 2006, and its earnings growth during that time slowed from its growth rate throughout the 1990s. It pays to monitor your investments' price and volume activity. That's how you stop losing and start winning.

Should You Day Trade?

One type of investing that I have always discouraged people from doing is day trading, where you buy and sell stocks on the same day. Most investors lose money doing this. The reason is simple: you are dealing predominantly with minor daily fluctuations that are harder to read than basic trends over a longer time period. Besides, there's generally not enough profit potential in day trading to offset the commissions you generate and the losses that will inevitably occur. Don't try to make money so fast. Rome wasn't built in a day.

There is a new form of day trading that is more like short-term swing trading (buying a stock on the upswing and selling before an inevitable pull-back). It involves buying a stock at its exact pivot buy point off a chart (coming out of a base or price consolidation area) and selling it five or so days later after the breakout. Sometimes pivot points off patterns such as the cup-with-handle pattern (see Chapter 2) identified on intraday charts of five-minute intervals can reveal a stock that is breaking out from an intraday pattern. If this is done with real skill in a positive market, it might work for some people, but it requires lots of time, study, and experience.

Should You Use Margin?

In the first year or two, while you're still learning to invest, it's much safer to invest on a cash basis. It usually takes most new investors at least two to three years before they gain enough market experience (by making several bad decisions, wasting time trying to reinvent the wheel, and experimenting with unsound beliefs) to be able to make and keep significant profits. Once you have a few years' experience, a sound plan, and a strict set of both buy and sell rules, you might consider buying on margin (using borrowed money from your brokerage firm in order to purchase more stock). Generally, margin buying should be done by younger investors who are still working. Their risk is somewhat less because they have more time to prepare for retirement.

The best time to use margin is generally during the first two years of a new bull market. Once you recognize a new bear market, you should get off margin immediately and raise as much cash as possible. You must under-

stand that when the general market declines and your stocks start sinking, you will lose your initial capital twice as fast if you're fully margined than you would if you were invested on a cash basis. This dictates that you absolutely *must* cut all losses quickly and get off margin when a major general market deterioration begins. If you speculate in small-capitalization or high-tech stocks fully margined, a 50% correction can cause a total loss. This happened to some new investors in 2000 and early 2001.

You don't have to be fully margined all the time. Sometimes you'll have large cash reserves and no margin. At other times, you'll be invested on a cash basis. At still other points, you'll be using a small part of your margin buying power. And in a few instances, when you're making genuine progress in a bull market, you may be fully invested on margin. All of this depends on the current market situation and your level of experience. I've always used margin, and I believe it offers a real advantage to an experienced investor who knows how to confine his buying to high-quality market leaders and has the discipline and common sense to always cut his losses short *with no exceptions*.

Your margin interest expense, depending on laws that change constantly, might be tax-deductible. However, in certain periods, margin interest rates can become so high that the probability of substantial success may be limited. To buy on margin, you'll also need to sign a margin agreement with your broker.

Never Answer a Margin Call

If a stock in your margin account collapses in value to the point where your stockbroker asks you to either put up money or sell stock, *don't put up money*; think about selling stock. Nine times out of ten, you'll be better off. The marketplace is telling you that you're on the wrong path, you're getting hurt, and things aren't working. So sell and cut back your risk level. Again, why throw good money after bad? What will you do if you put up good money and the stock continues to decline and you get more margin calls? Go broke backing a loser?

Should You Sell Short?

I did some research and wrote a booklet on short selling in 1976. It's now out of print, but not much has changed on the subject since then. In 2005, the booklet was the basis for a book titled *How to Make Money Selling Short*. The book was written with Gil Morales, who rewrote, revised, and updated my earlier work. Short selling is still a topic few investors understand and an endeavor at which even fewer succeed, so consider carefully

whether it's right for you. More active and seasoned investors might consider limited short selling. But I would want to keep the limit to 10% or 15% of available money, and most people probably shouldn't do even that much. Furthermore, short selling is far more complicated than simply buying stocks, and most short sellers are run in and lose money.

What is short selling? Think of it as reversing the normal buy and sell process. In short selling, you sell a stock (instead of buying it)—even though you don't own it and therefore must borrow it from your broker—in the hope that it will go down in price instead of up. If the stock falls in price as you expect, you can “cover your short position” by buying the stock in the open market at a lower price and pocket the difference as your profit. You would sell short if you think the market is going to drop substantially or a certain stock is ready to cave in. You sell the stock first, hoping to buy it back later at a lower price.

Sounds easy, right? Wrong. Short selling rarely works out well. Usually the stock that you sell short, expecting a colossal price decrease, will do the unexpected and begin to creep up in price. When it goes up, you lose money.

Effective short selling is usually done at the beginning of a new general market decline. This means you have to short based on the behavior of the daily market averages. This, in turn, requires the ability to (1) interpret the daily Dow, S&P 500, or Nasdaq indexes, as discussed in Chapter 9, and (2) select stocks that have had tremendous run-ups and have definitely topped out months earlier. In other words, your timing has to be flawless. You may be right, but if you're too early, you can be forced to cover at a loss.

In selling short, you also have to minimize your risk by cutting your losses at 8%. Otherwise, the sky's the limit, as your stock could have an unlimited price increase.

My first rule in short selling: don't sell short during a bull market. Why fight the overall tide? But sooner or later you may disregard the advice in this book, try it for yourself, and find out the same hard way—just as you learn that “wet paint” signs usually mean what they say. In general, you should save the short selling for bear markets. Your odds will be a little better.

The second rule is: never sell short a stock with a small number of shares outstanding. It's too easy for market makers and professionals to run up a thinly capitalized stock on you. This is called a “short squeeze” (meaning you could find yourself with a loss and be forced to cover by buying the stock back at a higher price), and when you're in one, it doesn't feel very good. It's safer to short stocks that are trading an average daily volume of 5 to 10 million shares or more.

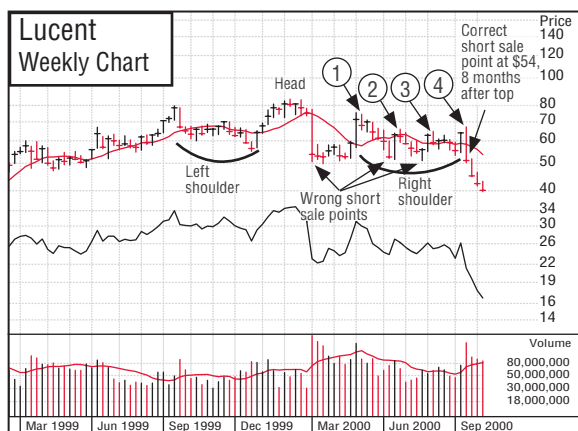
The two best chart price patterns for selling short are shown on the two graphs on page 288.

1. The “head-and-shoulders” top. The “right shoulder” of the price pattern on the stock chart *must* be slightly lower than the left. The correct time to short is when the third or fourth pullback up in price during the right shoulder is about over. (Note the four upward pullbacks in the right shoulder of the Lucent Technologies head-and-shoulders top.) One of these upward price pullbacks will reach slightly above the peak of a rally a few weeks back. This serves to run in the premature short sellers. Former big market leaders that have broken badly can have several upward price pullbacks of 20% to 40% from the stock’s low point in the right shoulder. The stock’s last run-up should cross over its moving average line. The right time to short is when the volume picks up as the stock reverses lower and breaks below its 10-week moving average line on volume but hasn’t yet broken to new low ground, at which point it is too late and then becomes too obvious and apparent to most traders. In some, but not all, cases, either there will be a deceleration in quarterly earnings growth or earnings will have actually turned down. The stock’s relative strength line should also be in a clear downtrend for at least 20 weeks up to 34 weeks. In fact, we found through research on model stocks over 50 years that almost all outstanding short-selling patterns occurred five to seven months after a formerly huge market leader has clearly topped.

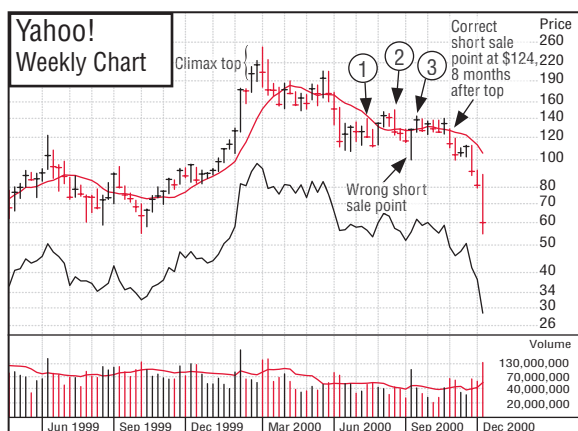
John Wooden, the great UCLA basketball coach, used to tell his players, “It’s what you learn after you know it all that counts.” Well, one know-it-all investor wrote and told us that we obviously didn’t know what we were talking about, that no knowledgeable person would ever sell a stock short seven months after it had topped. Few people understand this, and most short sellers lose money because of premature, faulty, or overly obvious timing. Lucent at point 4 was in its eighth month and fell 89%. Yahoo! was in its eighth month after it had clearly topped, and it then fell 87%. Big egos in the stock market are very dangerous . . . because they lead you to think you know what you’re doing. The smarter you are, the more losses ego can create. Humility and respect for the market are more valuable traits.

2. Third- or fourth-stage cup-with-handle or other patterns that have definitely failed after attempted breakouts. The stock should be picking up trading volume and starting to break down below the “handle” area. (See Chapter 2 on chart reading and failed breakouts.)

For years, short selling had to be executed on an “uptick” from the previous trade. An uptick is any trade that is higher than the previous trade by at least a penny. (It used to be $\frac{1}{8}$ or $\frac{1}{4}$ point or more up.) Therefore, orders should normally be entered either at the market or at a maximum, with a



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limit of \$0.25 or so *below* the last price. A weak stock could trade down a point or more without having an uptick.

After a careful study, the SEC recently rescinded the uptick rule. It should and probably will be reinstated at some point, with more than a penny price increase being required—perhaps a 10- or 20-cent rally. This should reduce volatility in some equities, especially in bad, panicky markets. The uptick rule was originally created in early 1937 after the market had broken seriously in the prior year. Its purpose was to require a $\frac{1}{8}$ or $\frac{1}{4}$ of 1 point uptick, which would be $12\frac{1}{2}$ or 25 cents, to slow down the uninterrupted hammering that a stock would be subject to during severe market breaks.

One alternative to selling short is buying put options, which don't need an uptick to receive an executed trade. You could also short tracking indexes like the QQQs (Nasdaq 100), SMHs (semiconductors), or BBHs (biotech). These also do not require an uptick.

Shorting must be done in a margin account, so check with your broker to see if you can borrow the stock you want to sell short. Also, if the stock pays a dividend while you are short, you'll have to pay the dividend to the person who owned the stock you borrowed and sold. Lesson: don't short big dividend-paying stocks.

Short selling is treacherous even for professionals, and only the more able and daring should give it a try. One last warning: don't short an advancing stock just because its price or the P/E ratio seems too high. You could be taken to the cleaners.

What Are Options, and Should You Invest in Them?

Options are an investment vehicle where you purchase rights (contracts) to buy ("call") or sell ("put") a stock, stock index, or commodity at a specified price before a specified future time, known as the option expiration date. Options are very speculative and involve substantially greater risks and price volatility than common stocks. Therefore, most investors should not buy or sell options. Winning investors should first learn how to minimize the investment risks they take, not increase them. After a person has proved that she is able to make money in common stocks and has sufficient investment understanding and actual experience, then the limited use of options could be intelligently considered.

Options are like making "all or nothing" bets. If you buy a three-month call option on McDonald's, the premium you pay gives you the right to purchase 100 shares of MCD at a certain price at any time during the next three months. When you purchase calls, you expect the price of the stock to go up, so if a stock is currently trading at \$120, you might buy a call at \$125. If the stock rises to \$150 after three months (and you have not sold your call option), you can exercise it and pocket the \$25 profit less the premium you paid. Conversely, if three months go by and your stock is down and didn't perform as expected, you would not exercise the option; it expires worthless, and you lose the premium you paid. As you might expect, puts are handled in a similar manner, except that you're making a bet that the price of the stock will decrease instead of increase.

Limiting Your Risk When It Comes to Options

If you do consider options, you should definitely limit the percentage of your total portfolio committed to them. A prudent limit might be no more than 10% to 15%. You should also adopt a rule about where you intend to cut and limit all of your losses. The percentage will naturally have to be more than 8%, since options are much more volatile than stocks. If an

option fluctuates three times as rapidly as the underlying stock, then perhaps 20% or 25% might be a possible absolute limit. On the profit side, you might consider adopting a rule that you'll take many of your gains when they hit 50% to 75%.

Some aspects of options present challenges. Buying options whose price can be significantly influenced by supply and demand changes as a result of a thin or illiquid market for that particular option is problematic. Also problematic is the fact that options can be artificially and temporarily overpriced simply because of a short-lived increase in price volatility in the underlying stock or the general market.

Buy Only the Best

When I buy options, which is rarely, I prefer to buy them for the most aggressive and outstanding stocks with the biggest earnings estimates, those where the premium you have to pay for the option is higher. Once again, you want options on the best stocks, not the cheapest. The secret to making money in options doesn't have much to do with options. You have to analyze and be right on the selection and timing of the underlying stock. Therefore, you should apply your CAN SLIM system and select the best possible stock at the best possible time.

If you do this and you are right, the option will go up along with the stock, except that the option should move up much faster because of the leverage.

By buying only options on the best stocks, you also minimize slippage caused by illiquidity. (Slippage is the difference between the price you wanted to pay and the price you actually paid at the time the order was executed. The more liquid the stock, the less slippage you should experience.) With illiquid (small-capitalization) stocks, the slippage can be more severe, and this ultimately could cost you money. Buying options on lower-priced, illiquid stocks is similar to the carnival game where you're trying to knock down all the milk bottles. The game may be rigged. Selling your options can be equally tricky in a thin (small-capitalization) stock.

In a major bear market, you might consider buying put options on certain individual stocks or on a major stock index like the S&P, along with selling shares of common stock short. The inability of your broker to borrow a stock may make selling short more difficult than buying a put. It is generally not wise to buy puts during a bull market. Why be a fish trying to swim upstream?

If you think a stock is going up and it's the right time to buy, then buy it, or purchase a long-term option and place your order at the market. If it's time to sell, sell at the market. Option markets are usually thinner and not as liquid as the markets for the underlying stock itself.

Many amateur option traders constantly place price limits on their orders. Once they get into the habit of placing limits, they are forever changing their price restraints as prices edge away from their limits. It is difficult to maintain sound judgment and perspective when you are worrying about changing your limits. In the end, you'll get some executions after tremendous excess effort and frustration.

When you finally pick the big winner for the year, the one that will triple in price, you'll lose out because you placed your order with a $\frac{1}{4}$ -point limit below the actual market price. You never make big money in the stock market by eighths and quarters.

You could also lose your shirt if your security is in trouble and you fail to sell and get out because you put a price limit on your sell order. Your objective is to be right on the big moves, not on the minor fluctuations.

Short-Term Options Are More Risky

If you buy options, you're better off with longer time periods, say, six months or so. This will minimize the chance your option will run out of time before your stock has had a chance to perform. Now that I've told you this, what do you think most investors do? Of course, they buy shorter-term option—30 to 90 days—because these options are cheaper and move faster in both directions, up and down!

The problem with short-term options is that you could be right on your stock, but the general market may slip into an intermediate correction, with the result that all stocks are down at the end of the short time period. You will then lose on all your options because of the general market. This is also why you should spread your option buying and option expiration dates over several different months.

Keep Option Trading Simple

One thing to keep in mind is that you should always keep your investments as simple as possible. Don't let someone talk you into speculating in such seemingly sophisticated packages as strips, straddles, and spreads.

A *strip* is a form of conventional option that couples one call and two puts on the same security at the same exercise price with the same expiration date. The premium is less than it would be if the options were purchased separately.

A *straddle* can be either long or short. A long straddle is a long call and a long put on the same underlying security at the same exercise price and with the same expiration month. A short straddle is a short call and a short put on the same security at the same exercise price and with the same expiration month.

A *spread* is a purchase and sale of options with the same expiration dates.

It's difficult enough to just pick a stock or an option that is going up. If you confuse the issue and start hedging (being both long and short at the same time), you could, believe it or not, wind up losing on both sides. For instance, if a stock goes up, you might be tempted to sell your put early to minimize the loss, and later find that the stock has turned downward and you're losing money on your call. The reverse could also happen. It's a dangerous psychological game that you should avoid.

Should You Write Options?

Writing options is a completely different story from buying options. I am not overly impressed with the strategy of writing options on stocks.

A person who writes a call option receives a small fee or premium in return for giving someone else (the buyer) the right to "call" away and buy the stock from the writer at a specified price, up to a certain date. In a bull market, I would rather be a buyer of calls than a writer (seller) of calls. In bad markets, just stay out or go short.

The writer of calls pockets a small fee and is, in effect, usually locked in for the time period of the call. What if the stock you own and wrote the call against gets into trouble and plummets? The small fee won't cover your loss. Of course, there are maneuvers the writer can take, such as buying a put to hedge and cover himself, but then the situation gets too complicated and the writer could get whipsawed back and forth.

What happens if the stock doubles? The writer gets the stock called away, and for a relatively small fee loses all chance for a major profit. Why take risks in stocks for only meager gains with no chance for large gains? This is not the reasoning you will hear from most people, but then again, what most people are saying and doing in the stock market isn't usually worth knowing.

Writing "naked calls" is even more foolish, in my opinion. Naked call writers receive a fee for writing a call on a stock they do not own, so they are unprotected if the stock moves against them.

It's possible that large investors who have trouble making decent returns on their portfolio may find some minor added value in writing short-term options on stocks that they own and feel are overpriced. However, I am always somewhat skeptical of new methods of making money that seem so easy. There are few free lunches in the stock market or in real estate.

Great Opportunities in Nasdaq Stocks

Nasdaq stocks are not traded on a listed stock exchange but instead are traded through over-the-counter dealers. The over-the-counter dealer market has been enhanced in recent years by a wide range of ECNs (electronic

communication networks), such as Instinet, SelectNet, Redibook, and Archipelago, which bring buyers and sellers together within each network, and through which orders can be routed and executed. The Nasdaq is a specialized field, and in many cases the stocks traded are those of newer, less-established companies. But now even NYSE firms have large Nasdaq operations. In addition, reforms during the 1990s have removed any lingering stigma that once dogged the Nasdaq.

There are usually hundreds of intriguing new growth stocks on the Nasdaq. It's also the home of some of the biggest companies in the United States. You should definitely consider buying better-quality Nasdaq stocks that have institutional sponsorship and fit the CAN SLIM rules.

For maximum flexibility and safety, it's vital that you maintain marketability in all your investments, regardless of whether they're traded on the NYSE or on the Nasdaq. An institutional-quality common stock with larger average daily volume is one defense against an unruly market.

Should You Buy Initial Public Offerings (IPOs)?

An initial public offering is a company's first offering of stock to the public. I usually don't recommend that investors purchase IPOs. There are several reasons for this.

Among the numerous IPOs that occur each year, there are a few outstanding ones. However, those that are outstanding are going to be in such hot demand by institutions (who get first crack at them) that if you are able to buy them at all, you may receive only a tiny allotment. Logic dictates that if you, as an individual investor, can acquire all the shares you want, they are possibly not worth having.

The Internet and some discount brokerages have made IPOs more accessible to individual investors, although some brokers place limits on your ability to sell soon after a company comes public. This is a dangerous position to be in, since you may not be able to get out when you want to. You may recall that during the IPO craze of 1999 and early 2000, there were some new stocks that rocketed on their first day or two of trading, only to collapse and never recover.

Many IPOs are deliberately underpriced and therefore shoot up on the first day of trading, but more than a few could be overpriced and drop.

Because IPOs have no trading history, you can't be sure whether they're overpriced. In most cases, this speculative area should be left to experienced institutional investors who have access to the necessary in-depth research and who are able to spread their new issue risks among many different equities.

This is not to say that you can't purchase a new issue after the IPO when the stock is up in its infancy. Google should have been bought in mid-September 2004, in the fifth week after its new issue, when it made a new high at \$114. The safest time to buy an IPO is on the breakout from its first correction and base-building area. Once a new issue has been trading in the market for one, two, or three months or more, you have valuable price and volume data that you can use to better judge the situation.

Within the broad list of new issues of the previous three months to three years, there are always standout companies with superior new products and excellent current and recent quarterly earnings and sales that you should consider. (*Investor's Business Daily's* "The New America" page explores most of them. Past articles on a company may be available.) CB Richard Ellis formed a perfect flat base after its IPO in the summer of 2004 and then rose 500%.

Experienced investors who understand correct selection and timing techniques should definitely consider buying new issues that show good positive earnings and exceptional sales growth, and also have formed sound price bases. They can be a great source of new ideas if they are dealt with in this fashion. Most big stock winners in recent years had an IPO at some point in the prior one to eight or ten years. Even so, new issues can be more volatile and occasionally suffer massive corrections during difficult bear markets. This usually happens after a period of wild excess in the IPO market, where any and every offering seems to be a "hot issue." For example, the new issue booms that developed in the early 1960s and the beginning of 1983, as well as that in late 1999 and early 2000, were almost always followed by a bear market period.

Congress, at this writing in early 2009, should consider lowering the capital gains tax to create a powerful incentive for thousands of new entrepreneurs to start up innovative new companies. Our historical research proved that 80% of the stocks that had outstanding price performance and job creation in the 1980s and 1990s had been brought public in the prior eight to ten years, as mentioned earlier. America now badly needs a renewed flow of new companies to spark new inventions and new industries . . . and a stronger economy, millions more jobs, and millions more taxpayers. It has always paid for Washington to lower capital gains taxes. This will be needed to reignite the IPO market and the American economy after the economic collapse that the subprime real estate program and the credit crisis caused in 2008. I learned many years ago that if rates are raised, many investors will simply not sell their stock because they don't want to pay the tax and then have significantly less money to reinvest. Washington can't seem to understand this simple fact. Fewer people will sell their stocks, and the govern-

ment will always get less revenue, not more. I've had many older, retired people tell me they will keep their stock until they die so they won't have to pay the tax.

What Are Convertible Bonds, and Should You Invest in Them?

A convertible bond is one that you can exchange (convert) for another investment category, typically common stock, at a predetermined price. Convertible bonds provide a little higher income to the owner than the common stock typically does, along with the potential for some possible profits.

The theory goes that a convertible bond will rise almost as fast as the common stock rises, but will decline less during downturns. As so often happens with theories, the reality can be different. There is also a liquidity question to consider, since convertible bond markets may dry up during extremely difficult periods.

Sometimes investors are attracted to this medium because they can borrow heavily and leverage their commitment (obtain more buying power). This simply increases your risk. Excessive leverage can be dangerous, as Wall Street and Washington learned in 2008.

It is for these several reasons that I do not recommend that most investors buy convertible bonds. I have also never bought a corporate bond. They are poor inflation hedges, and, ironically, you can also lose a lot of money in the bond market if you make what ultimately turns out to be a higher-risk investment in stretching for a higher yield.

Should You Invest in Tax-Free Securities and Tax Shelters?

The typical investor should not use these investment vehicles (IRAs, 401(k) plans, and Keoghs excepted), the most common of which are municipal bonds. Overconcern about taxes can confuse and cloud investors' normally sound judgment. Common sense should also tell you that if you invest in tax shelters, there is a much greater chance the IRS may decide to audit your tax return.

Don't kid yourself. You can lose money in munis if you buy them at the wrong time or if the local or state government makes bad management decisions and gets into real financial trouble, which some of them have done in the past.

People who seek too many tax benefits or tax dodges frequently end up investing in questionable or risky ventures. The investment decision should always be considered first, with tax considerations a distant second.

This is America, where anyone who really works at it can become successful at saving and investing. Learn how to make a net profit and, when you do, be happy about it rather than complaining about having to pay taxes because you made a profit. Would you rather hold on until you have a loss so you have no tax to pay? Recognize at the start that Uncle Sam will always be your partner, and he will receive his normal share of your wages and investment gains.

I have never bought a tax-free security or a tax shelter. This has left me free to concentrate on finding the best investments possible. When these investments work out, I pay my taxes just like everybody else. Always remember . . . the U.S. system of freedom and opportunity is the greatest in the world. Learn to use, protect, and appreciate it.

Should You Invest in Income Stocks?

Income stocks are stocks that have high and regular dividend yields, providing taxable income to the owner. These stocks are typically found in supposedly more conservative industries, such as utilities and banks. Most people should not buy common stocks for their dividends or income, yet many people do.

People think that income stocks are conservative and that you can just sit and hold them because you are getting your dividends. Talk to any investor who lost big on Continental Illinois Bank in 1984 when the stock plunged from \$25 to \$2, or on Bank of America when it crashed from \$55 to \$5 as of the beginning of 2009, or on the electric utilities caught up in the past with nuclear power plants. (Ironically, *17 major nations* now get or for years have gotten more of their electricity from nuclear power plants than the United States does. France gets 78% of its electricity from nuclear power.)

Investors also got hurt when electric utilities nosedived in 1994, and the same was true when certain California utilities collapsed in 2001. In theory, income stocks should be safer, but don't be lulled into believing that they can't decline sharply. In 1999–2000, AT&T dropped from over \$60 to below \$20.

And how about the aforementioned Citigroup, the New York City bank that so many institutional investors owned? I don't care how much it paid in dividends; if you owned Citigroup at \$50 and watched it nosedive to \$2, when it was in the process of going bankrupt until the government bailed it out, you lost an enormous amount of money. Incidentally, even if you do invest in income stocks, you should use charts. In October of 2007, Citigroup stock broke wide open on the *largest volume month that it ever traded*, so that even an amateur chartist could have recognized this and easily sold it in the \$40s, avoiding a serious loss.

If you do buy income stocks, *never strain to buy the highest dividend yield available*. That will typically entail much greater risk and lower quality. Trying to get an extra 2% or 3% yield can significantly expose your capital to larger losses. That's what a lot of Wall Street firms did in the real estate bubble, and look what happened to their investments. A company can also cut its dividends if its earnings per share are not adequately covering those payouts, leaving you without the income you expected to receive. This too has happened.

If you need income, my advice is to concentrate on the very best-quality stocks and simply withdraw 6% of your investments each year for living expenses. You could sell off a few shares and withdraw 1½% per quarter. Higher rates of withdrawal are not usually advisable, since in time they might lead to some depletion of your principal.

What Are Warrants, and Are They Safe Investments?

Warrants are an investment vehicle that allows you to purchase a specific amount of stock at a specific price. Sometimes warrants are good for a certain period of time, but it's common for them not to have time limits. Many of them are cheap in price and therefore seem appealing.

However, most investors should shy away from low-priced warrants. This is another complex, specialized field that sounds fine in concept but that few investors truly understand. The real question comes down to whether the common stock is correct to buy. Most investors will be better off if they forget the field of warrants.

Should You Invest in Merger Candidates?

Merger candidates can often behave erratically, so I don't recommend investing in them. Some merger candidates run up substantially in price on rumors of a possible sale, only to have the price drop suddenly when a potential deal falls through or other unforeseen circumstances occur. In other words, this can be a risky, volatile business, and it should generally be left to experienced professionals who specialize in this field. It is usually better to buy sound companies, based on your basic CAN SLIM evaluation, than to try to guess whether a company will be sold or merged with another.

Should You Buy Foreign Stocks?

Yes, the best foreign stocks have excellent potential when bought at the right time and right place, but I don't suggest that you get heavily invested

in them. The potential profit from a foreign stock should be a bit more than that from a standout U.S. company to justify the possible additional risk. For example, investors in foreign stocks must understand and follow the general market of the particular country involved. Sudden changes in that country's interest rates, currency, or government policy might in one unexpected action, make your investment less attractive.

It isn't essential for you to search out a lot of foreign stocks when there are more than 10,000 securities to select from in the United States. Many outstanding foreign stocks also trade in the United States, and many had excellent success in the past, including Baidu, Research In Motion, China Mobile, and América Móvil. I owned two of them in the 2003–2007 bull market. Several benefited from the worldwide wireless boom, but corrected 60% or more in the bear market that followed this bull move. There are also several mutual funds that excel in foreign securities.

As weak as our stock market was in 2008, many foreign markets declined even more. Baidu, a Chinese stock leader, dropped from \$429 to \$100. And the Russian market plummeted straight down from 16,291 to 3,237 once Putin invaded and intimidated the nation of Georgia.

Avoid Penny Stocks and Low-Priced Securities

The Canadian and Denver markets list many stocks that you can buy for only a few cents a share. I strongly advise that you avoid gambling in such cheap merchandise, because everything sells for what it's worth. You get what you pay for.

These seemingly cheap securities are unduly speculative and extremely low in quality. The risk is much higher with them than with better-quality, higher-priced investments. The opportunity for questionable or unscrupulous promotional practices is also greater with penny stocks. I prefer not to buy any common stock that sells for below \$15 per share, and so should you. Our extensive historical studies of 125 years of America's super winners show that most of them broke out of chart bases between \$30 and \$50 a share.

What Are Futures, and Should You Invest in Them?

Futures involve buying or selling a specific amount of a commodity, financial issue, or stock index at a specific price on a specific future date. Most futures fall into the categories of grains, precious metals, industrial metals, foods, meats, oils, woods, and fibers (known collectively as commodities); financial issues; and stock indexes. The financial group includes government

T-bills and bonds, plus foreign currencies. One of the more active stock indexes traded is the S&P 100, better known by its ticker symbol OEX.

Large commercial concerns, such as Hershey, use the commodity market for “hedging.” For example, Hershey might lock in a current price by temporarily purchasing cocoa beans in May for December delivery, while arranging for a deal in the cash market.

It is probably best for most individual investors not to participate in the futures markets. Commodity futures are extremely volatile and much more speculative than most common stocks. It is not an arena for the inexperienced or small investor unless you want to gamble or lose money quickly.

However, once an investor has four or five years of experience and has unquestionably proven her ability to make money in common stocks, if she is strong of heart, she might consider investing in futures on a limited basis.

With futures, it is even more important that you be able to read and interpret charts. The chart price patterns in commodity prices are similar to those in individual stocks. Being aware of futures charts can also help stock investors evaluate changes in basic economic conditions in the country.

There are a relatively small number of futures that you can trade. Therefore, astute speculators can concentrate their analysis. The rules and terminology of futures trading are different, and the risk is far greater, so investors should definitely limit the proportion of their investment funds that they commit to futures. There are worrisome events involved in futures trading, such as “limit down” days, where a trader is not allowed to sell and cut a loss. Risk management (i.e., position size and cutting losses quickly) is never more important than when trading futures. You should also never risk more than 5% of your capital in any one futures position. There is an outside chance of getting stuck in a position that has a series of limit up or limit down days. Futures can be treacherous and devastating; you could definitely lose it all.

I have never bought commodity futures. I do not believe you can be a jack-of-all-trades. Learn just one field as completely as possible. There are thousands of stocks to choose from.

Should You Buy Gold, Silver, or Diamonds?

As you might surmise, I do not normally recommend investing in metals or precious stones.

Many of these investments have erratic histories. They were once promoted in an extremely aggressive fashion, with little protection afforded to the small investor. In addition, the dealer's profit markup on these investments may be excessive. Furthermore, these investments do not pay interest or dividends.

There will always be periodic, significant run-ups in gold stocks caused by fears or panics brought about by potential problems in certain countries. A few gold companies may also be in their own cycle, like Barrick Gold was in the late 1980s and early 1990s. This type of commodity-oriented trading can be an emotional and unstable game, so I suggest care and caution. Small investments in such equities, however, can be very timely and reasonable at certain points.

Should You Invest in Real Estate?

Yes, at the right time and in the right place. I am convinced that most people should work toward being able to own a home by building a savings account and investing in common stocks or a growth-stock mutual fund. Home ownership has been a goal for most Americans. The ability over the years to obtain long-term borrowed money with only a small or reasonable down payment has created the leverage necessary to eventually make real estate investments possible for most Americans.

Real estate is a popular investment vehicle because it is fairly easy to understand and in certain areas can be highly profitable. About two-thirds of American families currently own their own homes. Time and leverage usually pay off. However, this is not always the case. People can and do lose money in real estate under many of the following realistic unfavorable conditions:

1. They make a poor initial selection by buying in an area that is slowly deteriorating or is not growing, or the area in which they've owned property for some time deteriorates.
2. They buy at inflated prices after several boom years and just before severe setbacks in the economy or in the particular geographic area in which they own real estate. This might occur if there are major industry layoffs or if an aircraft, auto, or steel plant that is an important mainstay of a local community closes.
3. They get themselves personally overextended, with real estate payments and other debts that are beyond their means, or they get into inviting but unwise variable-rate loans that could create difficult problems later, or they take out and live off of home equity—borrowing, rather than paying down their mortgage over time.
4. Their source of income is suddenly reduced by the loss of a job, or by an increase in rental vacancies should they own rental property.
5. They are hit by fires, floods, tornadoes, earthquakes, or other acts of nature.

People can also be hurt by well-meaning government policies and social programs that were not soundly thought through before being implemented, promoted, managed, operated, and overseen by the government. The subprime fiasco from 1995 to 2008 was caused by a good, well-intended government program that became incompetent, mismanaged, and messed up, with totally unexpected consequences that caused many of the very people the government hoped to help to lose their homes. It also caused huge unemployment as business contracted. In the greater Los Angeles area alone, many minority homeowners in San Bernardino, Riverside, and Santa Ana were dramatically hurt by foreclosures.

Basically, no one should ever buy a home unless he or she can come up with a down payment of at least 5%, 10%, or 20% on their own and has a relatively secure job. You need to earn and save toward your home-buying goal. And avoid variable-rate loans and smooth-talking salespeople who talk you into buying homes to “flip,” which exposes you to far more risk. And finally, don’t take out home equity loans that can put your home in a greater risk position. Also beware of getting into the terrible habit of using credit cards to run up big debts. That’s a bad habit that will hurt you for years.

You can make money and develop skill by learning about and concentrating on the correct buying and selling of high-quality growth-oriented equities rather than scattering your efforts among the myriad high-risk investment alternatives. As with all investments, do the necessary research before you make your decision. Remember, there’s no such thing as a risk-free investment. Don’t let anyone tell you there is. If something sounds too easy and good to be true, watch out! Buyer beware.

To summarize so far, **diversification is good, but don’t overdiversify. Concentrate on a smaller list of well-selected stocks, and let the market help you determine how long each of them should be held. Using margin may be okay if you’re experienced, but it involves significant extra risk. Don’t sell short unless you know exactly what you’re doing. Be sure to learn to use charts to help with your selection and timing. Nasdaq is a good market for newer entrepreneurial companies, but options and futures have considerable risk and should be used only if you’re very experienced, and then they should be limited to a small percentage of your overall investments. Also be careful when investing in tax shelters and foreign stocks only traded in foreign markets.**

It’s best to keep your investing simple and basic—high-quality, growth-oriented stocks, mutual funds, or real estate. But each is a specialty, and you need to educate yourself so that you’re not dependent solely on someone else for sound advice and investments.

13

• CHAPTER •

Twenty-One Costly Common Mistakes Investors Make

Knute Rockne, the famous winning Notre Dame football coach, used to say, “Build up your weaknesses until they become your strong points.” The reason people either lose money or achieve mediocre results in the stock market is they simply make too many mistakes. It’s the same in your business, your life, or your career. You’re held back or have reverses not because of your strengths, but because of your mistakes or weaknesses that you do not recognize, face, and correct. Most people just blame somebody else. It is much easier to have excuses and alibis than it is to examine your own behavior realistically.

When I first wrote this book, I came across lots of people who were advising: “Concentrate on your strengths, not your weaknesses.” That sounded logical and reasonable in many situations. But now, after 50 years of day-to-day experience in America’s amazing stock market, where every cycle thrusts forward dozens of brand-new, innovative, entrepreneurial companies that keep building our nation, I can state this:

By far the greatest mistake 98% of all investors make is never spending time trying to learn where they made their mistakes in buying and selling (or not selling) stock and what they must stop doing and start doing to become more successful. In other words, you must *unlearn* many things you thought you knew that ain’t so, stop doing them, and start learning new, better rules and methods to use in the future.

The difference between successful people in any field and those who are not so successful is that the successful person will work and do what others are unwilling to do. Since the early 1960s, I have known or dealt with count-

less individual risk takers, from inexperienced beginners to smart professionals. What I've discovered is it doesn't matter whether you're just getting started or have many years, even decades, of investing experience. The fact is, experience is harmful if it continuously reinforces your ongoing bad habits. Success in the market is achieved by avoiding the classic mistakes most investors, whether public or professional, make.

Events in recent years should tell you it's time to educate yourself, take charge, and learn how to handle and take responsibility for your own financial future: your 401(k), your mutual funds, and your stock portfolio. These events include Bernie Madoff's theft of billions from supposedly intelligent people through his supersecretive operations, which were never transparent, as he never told anyone how he was investing their money; the public's heavy losses from the topping stock markets of 2000 and 2008; and the use of excess leverage by Wall Street firms that couldn't even manage their own money with prudence and intelligence, forcing them into bankruptcy or shotgun weddings.

You really can learn to invest with intelligence and skill. Many people have learned how to use sound rules and principles to protect and secure their financial affairs. Here are the key mistakes you'll need to avoid once you get serious and make up your mind you want better investment results:

1. Stubbornly holding onto your losses when they are very small and reasonable. Most investors could get out cheaply, but because they are human, their emotions take over. You don't want to take a loss, so you wait and you hope, until your loss gets so large it costs you dearly. This is by far the greatest mistake nearly all investors make; they don't understand that all common stocks are speculative and can involve large risks. Without exception, you should cut every single loss short. The rule I have taught in classes all across the nation for 45 years is to always cut all your losses immediately when a stock falls 7% or 8% below your purchase price. Following this simple rule will ensure you will survive another day to invest and capitalize on the many excellent opportunities in the future.

2. Buying on the way down in price, thus ensuring miserable results. A declining stock seems like a real bargain because it's cheaper than it was a few months earlier. In late 1999, a young woman I know bought Xerox when it dropped abruptly to a new low at \$34 and seemed really cheap. A year later, it traded at \$6. Why try to catch a falling dagger? Many people did the same thing in 2000, buying Cisco Systems at \$50 on the way down after it had been \$82. It never saw \$50 again, even in the 5-year 2003 to 2007 bull market. In April 2009, it sold for \$20.

3. Averaging down in price rather than averaging up when buying. If you buy a stock at \$40, then buy more at \$30 and average out your

cost at \$35, you are following up your losers and throwing good money after bad. This amateur strategy used in any individual stock could produce serious losses and weigh down your portfolio with a few big losers.

4. Not learning to use charts and being afraid to buy stocks going into new high ground off sound chart bases. The public generally thinks a stock making a new high price seems too high, but personal feelings and opinions are emotional and far less accurate than the market. The best time to buy a stock during any bull market is when the stock initially emerges from a price consolidation or sound “basing” area of at least seven or eight weeks. Get over the normal human desire of wanting to buy something cheap on the way down.

5. Never getting out of the starting gate properly because of poor selection criteria and not knowing exactly what to look for in a successful company. You need to understand what fundamental factors are crucial and what are simply not that important! Many investors buy fourth-rate, “nothing-to-write-home-about” stocks that are not acting particularly well; have questionable earnings, sales growth, and return on equity; and are not the true market leaders. Others overly concentrate in highly speculative or lower-quality, risky technology securities.

6. Not having specific general market rules to tell you when a correction in the market is beginning or when a market decline is most likely over and a new uptrend is confirmed. It’s critical that you recognize market tops and major market bottoms if you want to protect your account from excessive giveback of profits and significant losses. You must also know when the storm is over and the market itself tells you to buy back and raise your market commitments. You can’t go by your personal opinions, news, or your feelings. You must have precise rules and follow them. People wrongly think you can’t time the market.

7. Not following your buy and sell rules, causing you to make an increased number of mistakes. The soundest rules you create are of no help if you don’t develop the strict discipline to make decisions and act according to your historically proven rules and game plan.

8. Concentrating your effort on what to buy and, once your buy decision is made, not understanding when or under what conditions the stock must be sold. Most investors have no rules or plan for selling stocks, meaning that they are doing only half of the homework necessary to succeed. They just buy and hope.

9. Failing to understand the importance of buying high-quality companies with good institutional sponsorship and the importance of learning how to use charts to significantly improve selection and timing.

10. Buying more shares of low-priced stocks rather than fewer shares of higher-priced stocks. Many people think it's smarter to buy round lots of 100 or 1,000 low-priced shares. This makes them feel like they're getting a lot more for their money. They'd be better off buying 30 or 50 shares of higher-priced, better-quality, better-performing companies. Think in terms of *dollars* when you invest, not the number of shares you can buy. Buy the best merchandise available, not the cheapest.

Many investors can't resist \$2, \$5, or \$10 stocks, but most stocks selling for \$10 or less are cheap for a reason. They've either been deficient in the past or have something wrong with them now. Stocks are like anything else: the best quality rarely comes at the cheapest price.

That's not all. Low-priced stocks may cost more in commissions and markups. And since they can drop 15% to 20% faster than most higher-priced issues can, they also carry greater risk. Most professionals and institutions normally won't invest in \$5 and \$10 stocks, so these stocks do not have a top-notch following. Penny stocks are even worse. As discussed earlier, institutional sponsorship is one of the ingredients needed to help propel a stock higher in price.

Cheap stocks also have larger spreads in terms of the percentage difference between the bid and ask price. Compare a \$5 stock that trades \$5 bid, \$5.25 ask with a \$50 stock that trades \$50 bid, \$50.25 ask. On your \$5 stock, that \$0.25 difference is 5% of the bid price. On your \$50 stock, that \$0.25 difference is a negligible 0.5%. The difference is a factor of 10. As a result, with low-priced stocks, you tend to have much more ground to make up from your initial buy point just to break even and overcome the spread.

11. Buying on tips, rumors, split announcements, and other news events; stories; advisory-service recommendations; or opinions you hear from other people or from supposed market experts on TV. Many people are too willing to risk their hard-earned money on the basis of what someone else says, rather than taking the time to study, learn, and know for sure what they're doing. As a result, they risk losing a lot of money. Most rumors and tips you hear simply aren't true. Even if they are true, in many cases the stock concerned will ironically go down, not up as you assume.

12. Selecting second-rate stocks because of dividends or low price/earnings ratios. Dividends and P/E ratios aren't anywhere near as important as earnings per share growth. In many cases, the more a company pays in dividends, the weaker it may be. It may have to pay high interest rates to replenish the funds it is paying out in the form of dividends. Better-performing companies typically will not pay dividends. Instead, they reinvest their capital in research and development (R&D) or other corporate

improvements. Also, keep in mind that you can lose the amount of a dividend in one or two days' fluctuation in the price of the stock. As for P/E ratios, a low P/E is probably low because the company's past record is inferior. Most stocks sell for what they're worth at any particular time.

13. Wanting to make a quick and easy buck. Wanting too much, too fast—without doing the necessary preparation, learning the soundest methods, or acquiring the essential skills and discipline—can be your downfall. Chances are, you'll jump into a stock too fast and then be too slow to cut your losses when you are wrong.

14. Buying old names you're familiar with. Just because you used to work for General Motors doesn't necessarily make it a good stock to buy. Many of the best investments will be newer entrepreneurial names you won't know, but, with a little research, you could discover and profit from before they become household names.

15. Not being able to recognize (and follow) good information and advice. Friends, relatives, some brokers, and advisory services can all be sources of bad advice. Only a small minority are successful enough themselves to merit your consideration. Outstanding stockbrokers or advisory services are no more plentiful than outstanding doctors, lawyers, or ballplayers. Only one out of nine baseball players who sign professional contracts ever make it to the big leagues. Most of the ballplayers coming out of college simply are not even professional caliber. Many brokerage firms have gone out of business because they couldn't manage their own money wisely. In the 2000 era, some used unbelievable leverage. You never want to make excessive use of borrowed money. That will get you into trouble.

16. Cashing in small, easy-to-take profits while holding your losers. In other words, doing exactly the opposite of what you should be doing: cutting your losses short and giving your profits more time.

17. Worrying way too much about taxes and commissions. The name of the game is to first make a net profit. Excessive worrying about taxes usually leads to unsound investment decisions in the hope of achieving a tax shelter. You can also fritter away a good profit by holding on too long in an attempt to get a long-term capital gain. Some investors convince themselves they can't sell because of taxes, but that's ego trumping judgment.

The commissions associated with buying and selling stocks, especially through an online broker, are minor compared with the money to be made by making the right decisions in the first place and taking action when needed. The fact that you pay relatively low commissions and you can get out of your investment much faster are two of the biggest advantages of owning stock over owning real estate. People can get over their head in real estate and lose money when they overstep themselves. With instant liquid-

ity in equities, you can protect yourself quickly at low cost and take advantage of highly profitable new trends as they emerge.

18. Speculating too heavily in options or futures because you see them as a way to get rich quick. Some investors also focus mainly on shorter-term, lower-priced options that involve greater volatility and risk. The limited time period works against holders of short-term options. Some people also write “naked options” (selling options on stocks they do not even own), which amounts to taking greater risk for a potentially small reward.

19. Rarely transacting “at the market,” preferring instead to put price limits on buy and sell orders. By doing so, investors are quibbling over eighths and quarters of a point (or their decimal equivalents), rather than focusing on the stock’s larger and more important movement. With limit orders, you run the risk of missing the market completely and not getting out of stocks that should be sold to avoid substantial losses.

20. Not being able to make up your mind when a decision needs to be made. Many investors don’t know whether they should buy, sell, or hold, and the uncertainty shows they have no guidelines. Most people don’t follow a proven plan, a set of strict principles or buy and sell rules, to correctly guide them.

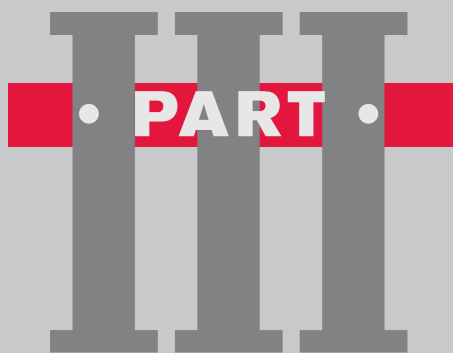
21. Not looking at stocks objectively. Many people pick favorites and cross their fingers. Instead of relying on hope and their own opinions, successful investors pay attention to the market, which is usually right.

How many of these describe your past investment beliefs? Poor methods yield poor results; sound methods yield sound results.

Here’s some special advice just for successful intelligent men who believe they are using CAN SLIM. Stop trying to make CAN SLIM much better by adding your favorite tools, market indicators, special formulas you’ve created, other services, publications, opinions of experts on TV, your own opinion of the economy or market, past habits, value measurements, or other diversions that dilute results and create confusion at decision time. Follow the rules, kick the ego, stay on track.

After all of this, never feel discouraged. Remember what Rockne said: “Build up your weaknesses until they become your strong points.” It takes time and a little effort to get it right, but it’s worth every minute you spend on it. America offers a never-ending parade of new, growing companies. You can learn to invest with knowledge and confidence to protect your money and find and properly handle highly successful companies. **You can learn how to successfully invest in stocks.**

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Investing Like a Professional



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• CHAPTER •

More Models of Great Stock Market Winners

Throughout this book, I've shown you and discussed many of the greatest winning stocks of the past. Now that you've been introduced to the CAN SLIM system of investing, you should know that we actually suggested some of these same companies to clients through our institutional services firm or bought them ourselves.

Regardless of your current position in life or your financial standing, it's clearly possible for you to make your dreams come true using the CAN SLIM system. You may have heard or read about the thousands of individuals who have changed their lives using this book and *Investor's Business Daily*. It really happens, and it can happen to you if you are determined and have an overpowering desire, no matter how large or small your account . . . as long as you make up your mind, work at it, and don't ever let yourself get discouraged.

This chapter will introduce you to a few early examples of success using this system. There are many, many others. In addition, it will also introduce you to more of the great winning stocks since 1952. Study this chapter closely; you'll find these patterns repeat over and over again throughout time. If you learn to recognize them early, you could get in on some future big profits, even if it takes some time.

Tracing the Growth of a Small Account

In 1961, with \$10 from each of my classmates at Harvard's Program for Management Development (PMD), we started the first PMD Fund with the grand

total of \$850. It was mostly for fun. Each classmate began with one \$10 share in the fund. Marshall Wolf, then with National Newark & Essex Bank, and later an executive vice president at Midatlantic National Bank, had the thankless job of secretary-treasurer, keeping the records, informing the gang, and filing and paying taxes each year. I got the easy job of managing the money.

It's an interesting account to study because it proves you can start very small and still win the game if you stick with sound methods and give yourself plenty of time. On September 16, 1986 (some 25 years later), after all prior taxes had been paid and with Marshall having later kept some money in cash, the account was worth \$51,653.34. The profit, in other words, was more than \$50,000, and each share was worth \$518. That is nearly a 50-fold after-tax gain from less than \$1,000 invested.

The actual buy and sell records in the accompanying table illustrate in vivid detail the execution of the basic investment methods we have discussed up to this point.

Note that while there were about 20 successful transactions through 1964, there were also 20 losing transactions. However, the average profit was around 20%, while the average loss was about 7%. If losses in Standard Kollsman, Brunswick, and a few others had not been cut, later severe price drops would have caused much larger losses. This small cash account was concentrated in only one or two stocks at a time. Follow-up buys were generally made if the security moved up in price.

The account made no progress in 1962, a bad market year, but it was already up 139% by June 6, 1963, *before* the first Syntex buy was made. By the end of 1963, the gain had swelled to 474% on the original \$850 investment.

The year 1964 was lackluster. Worthwhile profits were made in 1965, 1966, and 1967, although nothing like 1963, which was a very unusual year. I won't bore you with 20 pages of stock transactions. Let me just say that the next 10 years showed further progress, despite losses in 1969 and 1974.

Another period of interesting progress started in 1978 with the purchase of Dome Petroleum. All decisions beginning with Dome are picked up and shown in the second table.

Dome offers an extremely valuable lesson on why most stocks sooner or later have to be sold. While it was bought, as you can see, at \$77 and sold near \$98, it eventually fell below \$2! History repeated itself in 2000 and 2001 when many Internet big winners like CMGI dropped from \$165 to \$1. Note also that the account was worn out of Pic 'N' Save on July 6, 1982, at \$15, but we bought it back at \$18 and \$19, even though this was a higher price, and made a large gain by doing so. This is something you will have to learn to do at some point. If you were wrong in selling, in a number of cases, you'll need to buy the stock back at higher prices.

Shares	Stock	Date Bought	Price Paid	Date Sold	Price Sold	Gain or Loss
5	Bristol Myers	1/1/61	64.88	2/21/61	78.75	
7	Bristol Myers	1/4/61	67.25	2/21/61	78.75	149.87
18	Brunswick	2/21/61	53.75	3/10/61	68.00	223.35
29	Certain-teed	3/10/61	42.13	4/13/61	39.75	(104.30)
24	Stan. Kollsman	4/13/61	45.75	6/27/61	45.00	
	Stan. Kollsman		45.75	6/27/61	43.38	(82.66)
25	Endevco Corp.	4/26/61	13.00	5/25/61	17.50	102.96
10	Lockheed	6/13/61	44.88			
10	Lockheed	6/27/61	46.38			
5	Lockheed	7/25/61	48.50	8/29/61	48.25	7.55
6	Crown Cork	9/1/61	108.50			
5	Crown Cork	9/1/61	110.00	10/2/61	103.25	(100.52)
20	Brunswick	10/11/61	64.25	10/24/61	58.13	
	Brunswick			11/1/61	54.00	(223.49)
3	Polaroid	10/31/61	206.75			
3	Polaroid	11/1/61	209.00	2/21/62	180.00	(191.68)
30	Korvette	2/28/62	41.00	3/30/62	47.88	
30	Korvette	4/5/62	52.25	4/13/62	54.25	183.96
10	Crown Cork (Short)	5/28/62	99.25	5/22/62	97.25	(50.48)
30	Lockheed (Short)	6/15/62	41.25	6/2/62	39.75	(81.02)
5	Xerox	6/20/62	104.75			
5	Xerox	6/25/62	105.25	7/12/62	127.13	190.30
10	Homestake Mining	7/16/62	59.50	7/24/62	54.25	
10	Homestake Mining	7/16/62	58.75	7/24/62	54.25	(87.66)
10	Polaroid (Short)	7/31/62	105.00	7/19/62	97.88	(101.86)
30	Korvette (Short)	10/24/62	21.88	9/28/62	35.13	385.94
10	Chrysler	10/30/62	59.00			
15	Chrysler	11/1/62	60.34	1/15/63	83.63	545.40
15	RCA	1/16/63	62.50			
15	RCA	1/18/63	65.25	2/28/63	62.00	(111.02)
25	Coastal States	2/28/63	31.38	3/14/63	32.13	(8.46)
14	Chrysler	2/27/63	92.50			
8	Chrysler	3/14/63	93.00	4/16/63	109.13	300.03
25	Control Data	4/23/63	44.13	5/13/63	49.63	102.55
25	Intl. Minerals	5/6/63	52.88	5/15/63	54.88	11.47
22	Chrysler	5/13/63	54.38	6/10/63	61.75	
25	Chrysler	5/17/63	55.63	6/10/63	61.75	211.30
15	Syntex	6/11/63	89.25	9/23/63	146.13	
10	Syntex	8/7/63	114.50	9/23/63	146.13	
15	Syntex	10/9/63	149.13	10/22/63	225.00	2,975.71
15	Control Data	7/9/63	69.13	7/17/63	67.25	(59.62)
15	RCA	1/8/64	102.02	2/11/64	105.68	53.98
15	RCA	1/9/64	106.19	2/11/64	105.68	(8.49)
15	RCA	1/10/64	107.33	2/11/64	105.68	(25.54)
50	Pan Am	2/17/64	65.53	3/9/64	68.00	123.29
25	McDonnell Air	3/11/64	62.17	5/11/64	60.00	(54.26)
25	Chrysler	3/12/64	47.88	4/7/64	43.87	(100.35)
25	Chrysler	3/13/64	49.27	4/7/64	43.87	(135.06)
30	Chrysler	3/17/64	50.21	4/30/64	46.08	(123.83)
30	Consol. Cigar	3/19/64	49.35	4/20/64	47.25	(62.87)
25	Greyhound	4/7/64	55.47	5/1/64	57.63	53.88
20	Greyhound	4/8/64	58.55	5/1/64	57.63	(18.52)
15	Xerox	4/21/64	95.23	5/1/64	93.00	(33.41)
15	Xerox	4/29/64	98.53	5/5/64	95.00	(52.95)
30	Chrysler	5/13/64	52.14	7/8/64	48.75	(101.69)
50	Chrysler	5/13/64	52.32	6/11/64	46.50	(290.79)
50	Chrysler	5/13/64	52.34	6/30/64	49.00	(166.82)
50	Cerro Corp.	7/2/64	49.00	9/16/64	56.00	349.51
20	Cerro Corp.	7/6/64	50.68	9/16/64	56.00	106.50
50	NY Central RR	7/8/64	41.65	11/16/64	49.05	369.89

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PMD Fund Transactions, 1961-1964

Shares	Stock	Date Bought	Price Paid	Date Sold	Price Sold	Gain or Loss
100	Dome Petroleum	12/28/78	77.00			
20	Dome Petroleum			2/26/79	97.88	
320	4/1 split on 6/6/79			10/17/80	63.00	14,226.72
300	Fluor	10/17/80	56.50	2/9/81	48.25	(3,165.82)
50	Fluor	10/17/80	56.88			
100	Pic 'N' Save	6/4/81	55.00			
300	3/1 split 6/29/81			7/6/82	15.00	(1,094.00)
100	Espey Mfg.	11/19/81	46.75	6/8/82	38.00	
50	Espey Mfg.	11/19/81	47.00	4/23/82	46.00	(1,313.16)
100	MCI Comm.	4/23/82	37.00	8/20/82	36.38	(123.50)
96	MCI Comm.	7/6/82	45.50			
	2/1 split on 9/20/82			1/3/83	38.25	2,881.92
200	Pic 'N' Save	8/20/82	18.50	7/16/84	19.25	3,892.00
45	Hewlett Packard	9/10/82	53.00	8/11/83	82.88	1,307.35
100	Pic 'N' Save	8/27/82	19.50			
185	Pic 'N' Save	1/3/83	38.13			
	2/1 split on 12/1/83			2/1/85	23.25	4,115.02
200	Price Co.	7/6/84	39.25			
326	Price Co.	2/1/85	53.75			
8	Price Co.			3/25/85	57.00	
15	Price Co.			3/20/86	43.25	
	2/1 split on 2/11/86			6/17/86	49.88	26,489.87

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PMD Fund Transactions, 1978–1986

The U.S. Investing Championship

Another engaging example of the CAN SLIM principles being properly applied is the story of one of our associates, Lee Freestone. Lee participated in the U.S. Investing Championship in 1991, when he was just 24 years old. Using the CAN SLIM technique, he came in second for the year, with a result of 279%. In 1992, he gained a 120% return and again came in second. Lee was doing what David Ryan, another associate at the time, had done when he participated in the U.S. Investing Championship in prior years and won. The U.S. Investing Championship is not some paper transaction derby. Real money is used, and actual transactions are made in the market. Lee continued to invest successfully with even larger returns in the late 1990s.

So if it is followed with discipline, the CAN SLIM system has been battle-tested successfully through thick and thin from 1961 to 2009.

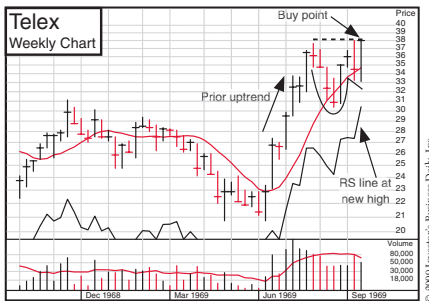
More Examples of Great Winners to Guide You

Graphs for an additional selected group of the greatest stock market winners follow. They are models of the most successful investments in the United States from 1952 through 2009. Study them carefully and refer to them often. They are further examples of what you must look for in the future. The thin wavy line with RS at the end shown below the prices is a relative price strength line. When the line moves up, the stock is outper-

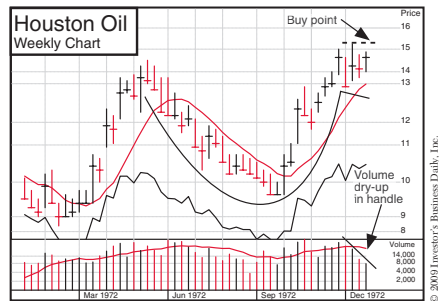
forming the market. All the models show the stock's chart pattern just before the point where you want to take buying action.

If you think you're just looking at a bunch of charts, think again. What you are seeing are pictures of the price accumulation patterns of the greatest winning stocks—just before their enormous price moves began. The charts are presented in five configurations: cup-with-handle pattern, cup-without-handle pattern, double-bottom pattern, flat-base pattern, and base-on-top-of-a-base pattern. You need to learn to recognize these patterns.

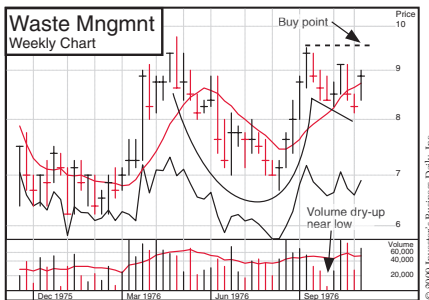
Cup-With-Handle Pattern



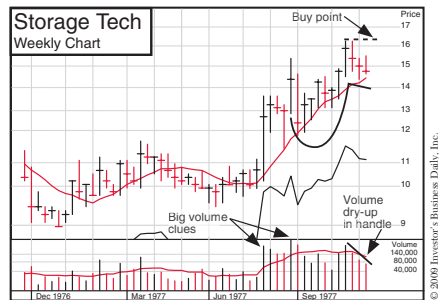
Telex 283% increase in 27 weeks



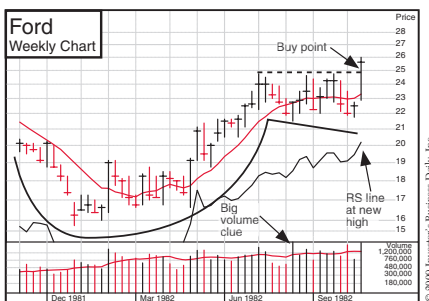
Houston Oil 1004% increase in 54 weeks



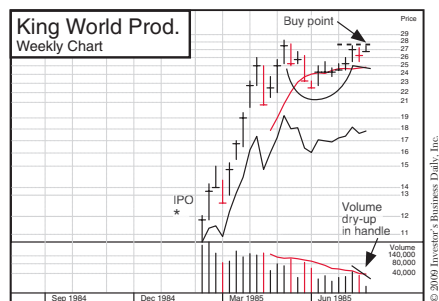
Waste Management 1180% increase in 242 weeks



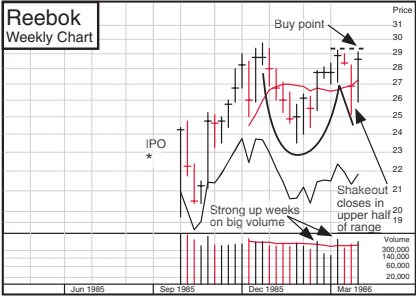
Storage Technology 371% increase in 52 weeks



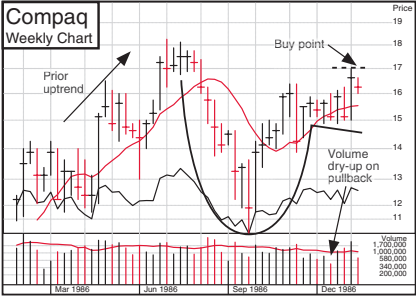
Ford 889% increase in 262 weeks



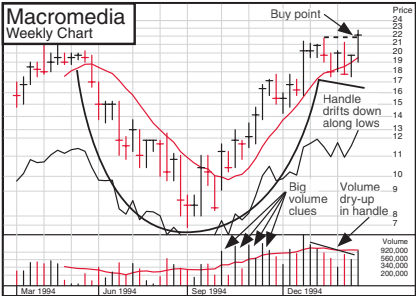
King World Prod. 588% increase in 116 weeks



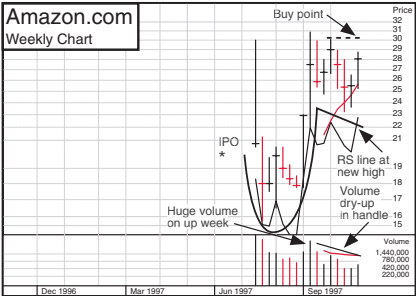
Reebok 246% increase in 18 weeks



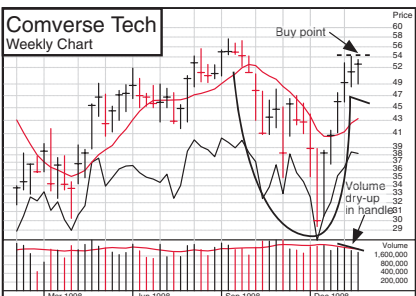
Compaq 352% increase in 46 weeks



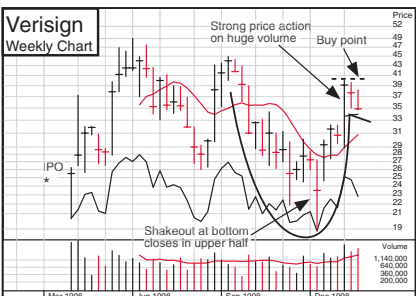
Macromedia 486% increase in 49 weeks



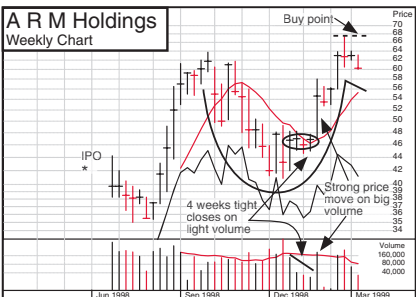
Amazon.com 3805% increase in 70 weeks



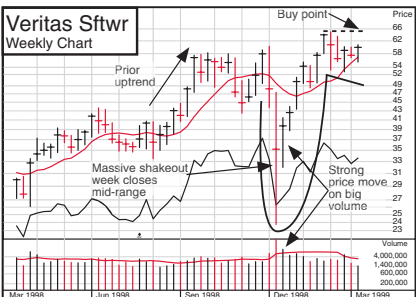
Comverse Technology 564% increase in 67 weeks



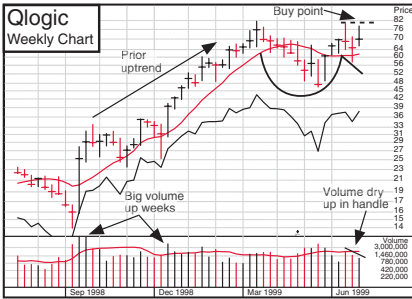
Verisign 2250% increase in 66 weeks



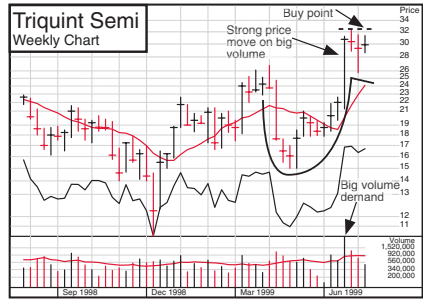
ARM Holdings 1385% increase in 57 weeks



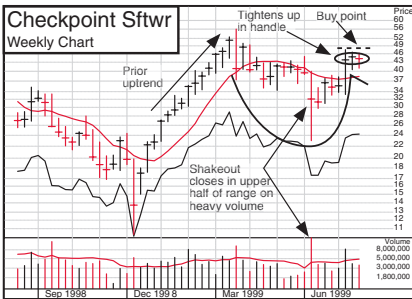
Veritas Software 1097% increase in 62 weeks



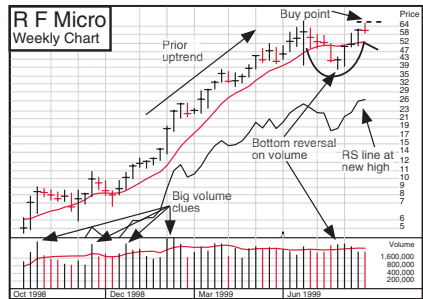
Qlogic 803% increase in 44 weeks



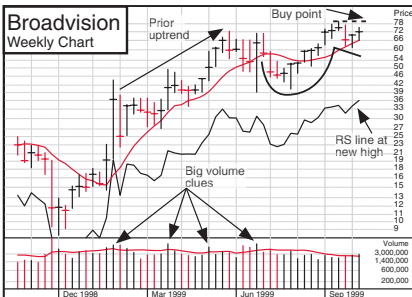
Triquant Semiconductor 1078% increase in 41 weeks



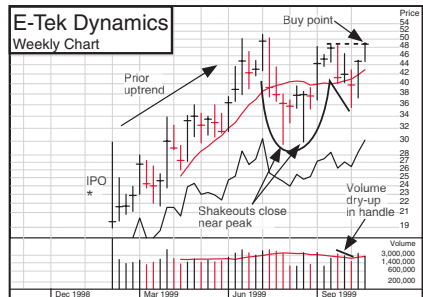
Checkpoint Software 1104% increase in 40 weeks



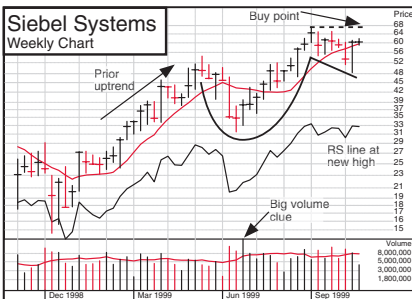
RF Micro Devices 444% increase in 36 weeks



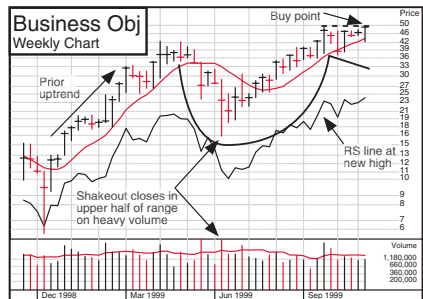
Broadvision 823% increase in 30 weeks



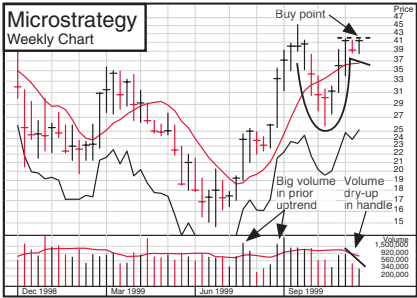
E-Tek Dynamics 507% increase in 28 weeks



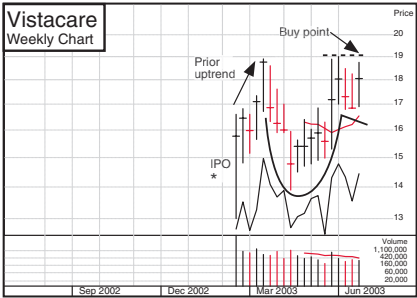
Siebel Systems 466% increase in 28 weeks



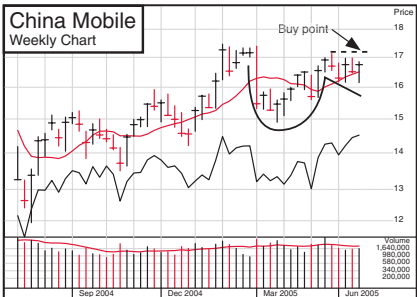
Business Objects 480% increase in 26 weeks



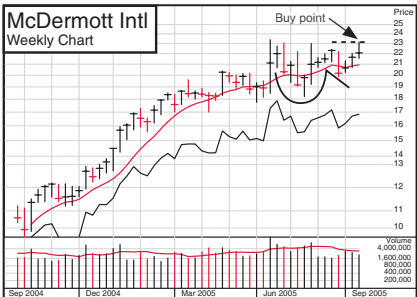
Microstrategy 1414% increase in 24 weeks



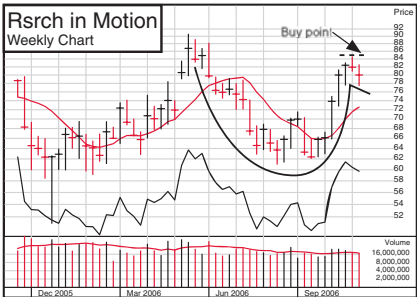
Vistacare 115% increase in 31 weeks



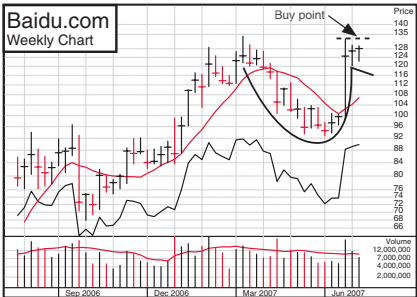
China Mobile 484% increase in 131 weeks



McDermott 703% increase in 128 weeks

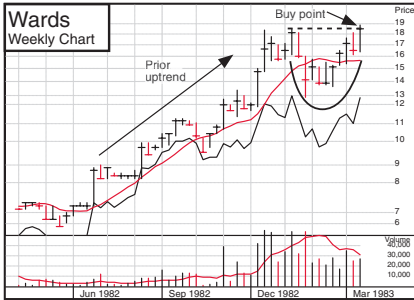


Research in Motion 382% increase in 60 weeks



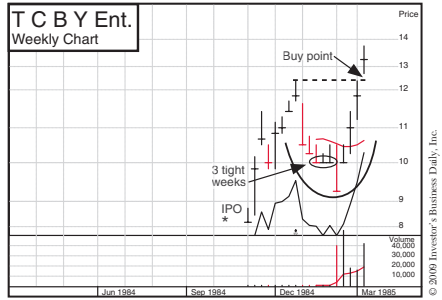
Baidu 225% increase in 25 weeks

Cup-Without-Handle Pattern



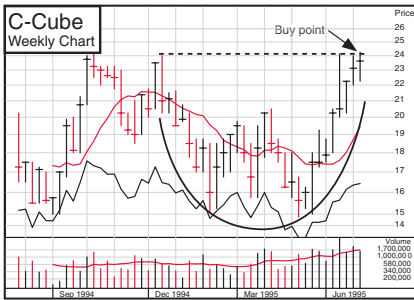
Wards 267% increase in 38 weeks

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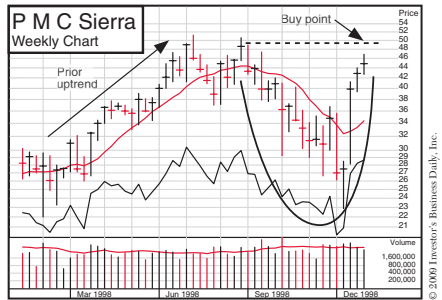
T C B Y 2189% increase in 77 weeks

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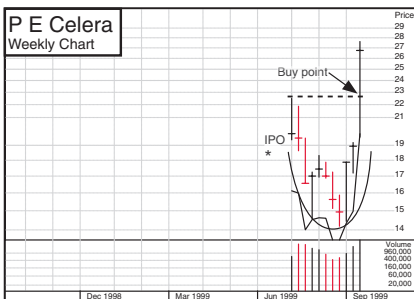
C-Cube 509% increase in 41 weeks

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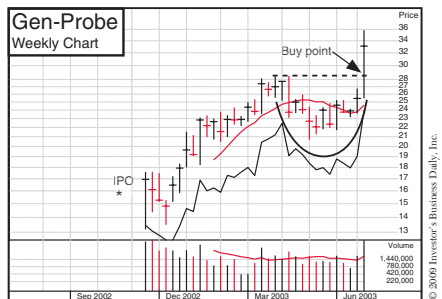
P M C Sierra 1949% increase in 70 weeks

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P E Celera 2281% increase in 32 weeks

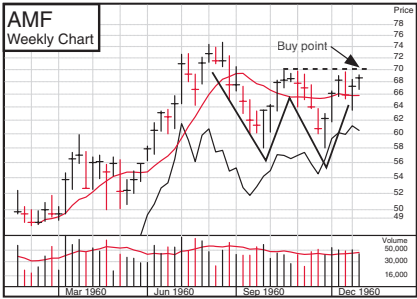
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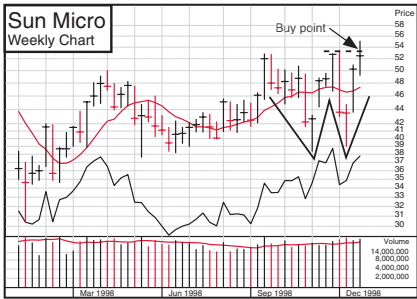
Gen-Probe 122% increase in 20 weeks

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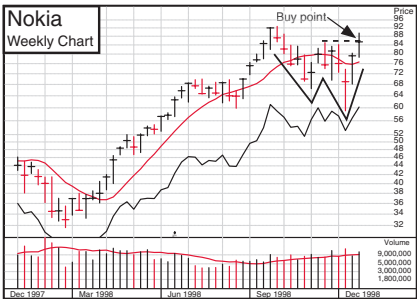
Double Bottom Pattern



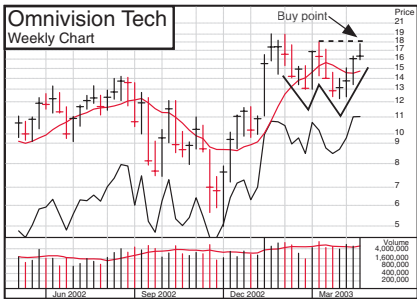
AMF 82% increase in 23 weeks



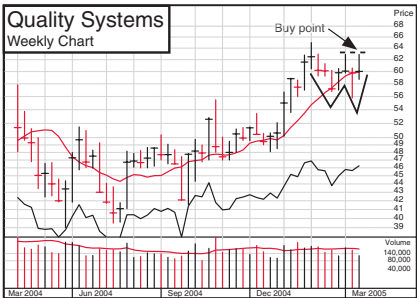
Sun Micro 701% increase in 74 weeks



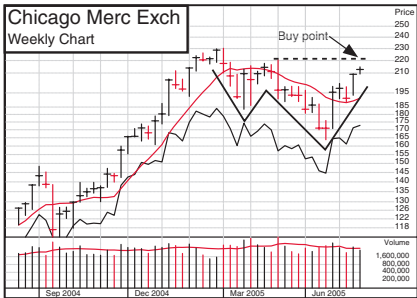
Nokia 486% increase in 87 weeks



Omnivision Tech 256% increase in 39 weeks

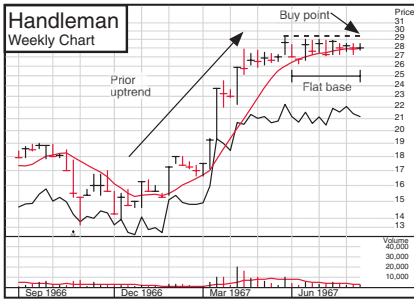


Quality Systems 177% increase in 44 weeks

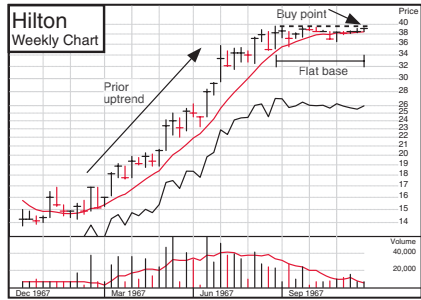


Chicago Merc. Exch. 208% increase in 132 weeks

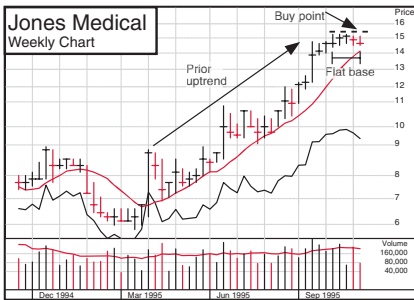
Flat Base Pattern



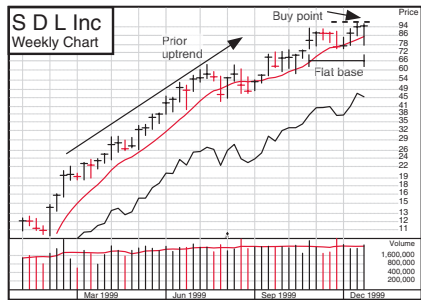
Handleman 328% increase in 139 weeks



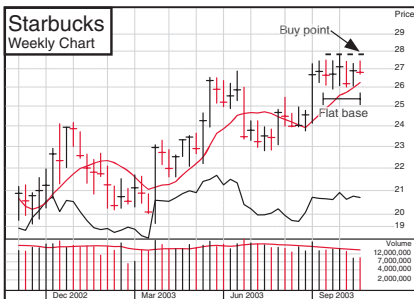
Hilton 232% increase in 60 weeks



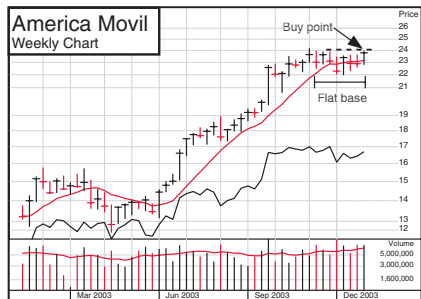
Jones Medical 447% increase in 36 weeks



S D L Inc 814% increase in 39 weeks

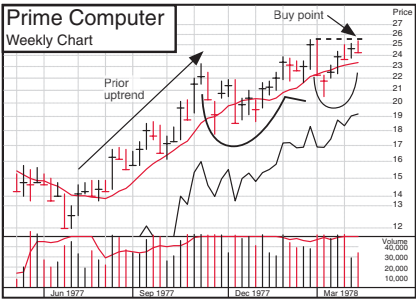


Starbucks 126% increase in 70 weeks

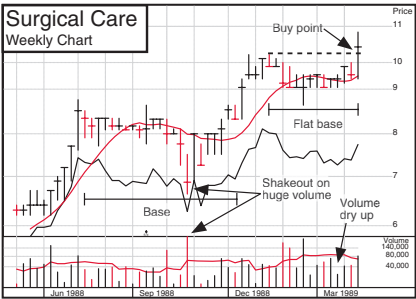


American Movil 730% increase in 205 weeks

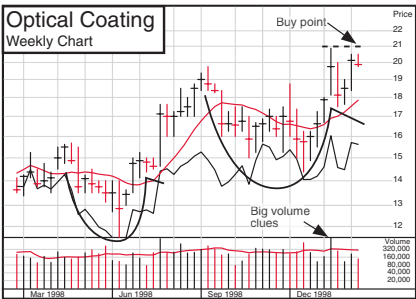
Base-on-Base Pattern



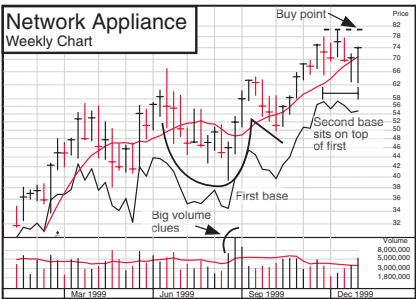
Prime Computer 1564% increase in 169 weeks



Surgical Care Affiliates 1632% increase in 150 weeks



Optical Coating Labs 1957% increase in 58 weeks



Network Appliance 517% increase in 18 weeks

15

• CHAPTER •

Picking the Best Market Themes, Sectors, and Industry Groups

The majority of the leading stocks are usually in leading industries. Studies show that 37% of a stock's price movement is directly tied to the performance of the industry group the stock is in. Another 12% is due to strength in its overall sector. Therefore, roughly half of a stock's move is driven by the strength of its respective group. Because specific industry groups lead each market cycle, you can see how worthwhile it is to consider a stock's industry before making a purchase.

For the purposes of this discussion, there are three terms we will use: sector, industry group, and subgroup. A *sector* is a broad grouping of companies and industries. These include, for example, basic industries (or “cyclicals”), consumer goods and services, transportation, finance, and high technology. An *industry group* is a smaller, more specific grouping of companies; there normally are several industry groups within a sector. A *subgroup* is even more specific, dividing the industry group into several very precise subcategories.

For example, if we were to look at Viacom, it could be described as follows: Sector: Leisure and Entertainment Industry; Group: Media; and Subgroup: Radio/TV. For clarity and ease of use, industry group and subgroup names are generally combined, with the result simply being called “industry groups.” For example, the industry group for Viacom is known as “Media—Radio/TV.”

Why Track 197 Industry Groups?

Why does IBD divide securities into 197 industry groups rather than, say, the smaller number of groups used by Standard & Poor's? It's simple really. The stocks within a given sector do not all perform at the same rate. Even if a sector is outperforming other sectors, there may be segments of that sector that are performing extremely well and others that are lagging the market. It's important that you be able to recognize what industry group within the sector is acting the very best, since this knowledge can mean the difference between superior and mediocre results.

Early in our study of the market, we realized that many of the investment services available at the time did not adequately dissect the market into enough industry groups. It was therefore difficult to determine the specific part of a group where the true leadership was. So we created our own industry groups, breaking down the market into 197 different subcategories and providing you, the investor, with more accurate and detailed insights into the makeup of an industry. For example, the medical industry can be divided into hospital companies, generic drugs, dental, home nursing, genetics, biotech, and HMOs, plus a few other unique modern areas.

How You Can Decide Which Industry Groups Are Leading the Market

When analyzing industries, we've found that some are so small that signs of strength in the group may not be relevant. If there are only two small, thinly traded companies within a subindustry, that's not enough to consider them a group. On the other hand, there are industries with too many companies, such as chemicals and savings and loans. This excessive supply does not add to these industries' attractiveness, unless some extremely unusual changes in industry conditions occur.

The 197 industry groups mentioned earlier can be found each business day in *Investor's Business Daily*. There we rank each subgroup according to its six-month price performance so that you can easily determine which industry subgroups are the true leaders. Buyers operating on the "undervalued" philosophy love to do their prospecting in the worst-ranked groups. But analysis has shown that, on average, stocks in the top 50 or 100 groups perform better than those in the bottom 100. To increase your odds of finding a truly outstanding stock in an outstanding industry, concentrate on the top 20 groups and avoid the bottom 20.

Both *Investor's Business Daily* and the Daily Graphs Online charting services offer an additional, proprietary source of information to help you

determine whether the stock you're thinking about owning is in a top-flight industry group. The Industry Group Relative Strength Rating assigns a letter grade from A+ to E to each publicly traded company we follow, with A+ being best. A rating of A+, A, or A- means the stock's industry group is in the top 24% of all industry groups in terms of price performance.

Every day I also quickly check the "New Price Highs" list in IBD. It is uniquely organized in order of the broad industry sectors with the most individual stocks that made new price highs the previous day. You can't find this list in other business publications. Just note the top six or so sectors, particularly in bull markets. They usually pick up the majority of the real leaders.

Another way you can find out what industry groups are in or out of favor is to analyze the performance of a mutual fund family's industry funds. Fidelity Investments, one of the nation's successful mutual fund managers, has more than 35 industry mutual funds. A glance at their performance provides yet another excellent perspective on which industry sectors are doing better. I've found it worthwhile to note the two or three Fidelity industry funds that show the greatest year-to-date performance. This is shown in a small special table in IBD every business day.

For William O'Neil + Co.'s institutional clients, a weekly Datagraph service is provided that arranges the 197 industry groups in order of their group relative price strength for the past six months. Stocks in the strongest categories are shown in Volume 1 of the O'Neil Database books, and stocks in the weaker groups are in Volume 2.

During a time period in which virtually all daily newspapers, including the *Wall Street Journal*, significantly cut the number of companies they covered in their main stock tables every business day and/or drastically cut the number of key data items shown daily for each stock, here's what *Investor's Business Daily* did.

IBD's stock tables are now organized in order of performance, from the strongest down to the weakest of 33 major economic sectors, such as medical, retail, computer software, consumer, telecom, building, energy, Internet, banks, and so on. Each sector combines NYSE and Nasdaq stocks so you can compare every stock available in each sector to find the best stocks in the best sectors based on a substantial number of key variables.

IBD now gives you 21 vital time-tested facts on up to 2,500 leading stocks in its stock tables each business day . . . more than virtually all other daily newspapers in America. These 21 facts are

1. An overall composite ranking from 1 to 99, with 99 best.
2. An earnings per share growth rating comparing each company's last two quarters and last three years' growth with those of all other

stocks. A 90 rating means the company has outperformed 90% of all stocks in a critical measurement, earnings growth.

- 3.** A Relative Price Strength rating comparing each stock's price change over the last 12 months with those of all other stocks. Better firms rate 80 or higher on both EPS and RS.
- 4.** A rating comparing a stock's sales growth rate, profit margins, and return on equity to those of all other stocks.
- 5.** A highly accurate proprietary accumulation/distribution rating that uses a price and volume formula to gauge whether a stock is under accumulation (buying) or distribution (selling) in the last 13 weeks. "A" denotes heavy buying; "E" indicates heavy selling.
- 6 & 7.** Volume % change tells you each stock's precise percentage change above or below its average daily volume for the past 50 days along with its total volume for the day.
- 8 & 9.** The current and recent relative performance of each stock's broad industry sector.
- 10–12.** Each stock's 52-week high price, closing price, and change for the day.
- 13–21.** Price/earnings ratio, dividend yield, if the company repurchased its stock in the last year, if the stock has options, if company earnings will be reported in the next four weeks, if the stock was up 1 point or more or made a new high, if the stock was down 1 point or more or made a new low, if the stock had an IPO in the last fifteen years and has an EPS and RS rating of 80 or higher, and if a recent IBD story on the company is archived at Investors.com.

Not only does IBD follow more stocks and provide more vital data, but the table print size is much larger and easier to read.

As of this writing in February 2009, the medical sector is number one. These ratings will change as the weeks and months go by and market conditions, news, and data change. I believe these significant and relevant data for serious investors, regardless of whether they are new or experienced, are light-years ahead of the data provided by most of IBD's competitors. IBD is the #1 daily business newspaper for investors.

Considering some of the seeming disasters coming out of Wall Street and the big-city banking community in 2008, we believe we are and have been providing the American public—with our many books like the one you're reading, home study courses, more than a thousand seminars and workshops nationwide, plus *Investor's Business Daily*—a source of relevant, sound education, help, and guidance in an otherwise complex but key area

that much of the investment community and Washington may not have always handled as well.

The Importance of Following Industry Trends

If economic conditions in 1970 told you to look for an improvement in housing and a big upturn in building, what stocks would you have included in your definition of the building sector? If you had acquired a list of them, you'd have found that there were hundreds of companies in that sector at the time. So how would you narrow down your choices to the stocks that were performing best? The answer: look at them from the industry group and subgroup levels.

There were actually 10 industry groups within the building sector for investors to consider during the 1971 bull market. That meant there were 10 different ways you could have played the building boom. Many institutional investors bought stocks ranging from lumber producer Georgia Pacific to wallboard leader U.S. Gypsum to building-products giant Armstrong Corp. You could have also gone with Masco in the plumbing group, a home builder like Kaufman & Broad, building-material retailers and wholesalers like Standard Brands Paint and Scotty's Home Builders, or mortgage insurers like MGIC. Then there were manufacturers of mobile homes and other low-cost housing, suppliers of air-conditioning systems, and makers and sellers of furniture and carpets.

Do you know where the traditional building stocks were during 1971? They spent the year in the bottom half of all industry groups, while the newer building-related subgroups more than tripled!

The mobile home group crossed into the top 100 industry groups on August 14, 1970, and stayed there until February 12, 1971. The group returned to the top 100 on May 14, 1971, and then fell into the bottom half again later the following year, on July 28, 1972. In the prior cycle, mobile homes were in the top 100 groups in December 1967 and dropped to the bottom half only in the next bear market.

The price advances of mobile home stocks during these positive periods were spellbinding. Redman Industries zoomed from a split-adjusted \$6 to \$56, and Skyline moved from \$24 to what equaled \$378 on a presplit basis. These are the kind of stocks that charts can help you spot if you learn to read charts and do your homework. We study the historical model of all these past great leaders and learn from them.

From 1978 to 1981, the computer industry was one of the leading sectors. However, many money managers at that time thought of the industry as consisting only of IBM, Burroughs, Sperry Rand, Control Data, and the like. But

these were all large mainframe computer manufacturers, and they failed to perform during that cycle. Why? Because while the computer sector was hot, older industry groups within it, such as mainframe computers, were not.

Meanwhile, the computer sector's many new subdivisions performed unbelievably. During that period, you could have selected new, relatively unknown stocks from groups such as minicomputers (Prime Computer), microcomputers (Commodore International), graphics (Computervision), word processors (Wang Labs), peripherals (Verbatim), software (Cullinane Database), or time-sharing (Electronic Data Systems). These fresh new entrepreneurial winners increased five to ten times in price. (That's the "New" in CAN SLIM.) No U.S. administration can hold back America's inventors and innovators for very long—unless it is really stifling business and the country.

During 1998 and 1999, the computer sector led again, with 50 to 75 computer-related stocks hitting the number one spot on *Investor's Business Daily's* new high list almost every day for more than a year. If you were alert and knew what to look for, it was there to be seen. It was Siebel Systems, Oracle, and Veritas in the enterprise software group, and Brocade and Emulex among local network stocks that provided new leadership. The computer-Internet group boomed with Cisco, Juniper, and BEA Systems; and EMC and Network Appliance had enormous runs in the memory group; while the formerly leading personal computer group lagged in 1999. After their tremendous increases, most of these leaders then topped in 2000 along with the rest of the market.

Many new subgroups have sprung up since then, and many more will spring up in the future as new technologies are dreamed up and applied. We are in the computer, worldwide communications, and space age. New inventions and technologies will spawn thousands of new and superior products and services. We're benefiting from an endless stream of ingenious offshoots from the original mainframe industry, and in the past they came so fast we had to update the various industry categories in our database more frequently just to keep up with them.

There is no such thing as "impossible" in America's free enterprise system. Remember, when the computer was first invented, experts thought the market for it was only two, and one would have to be bought by the government. And the head of Digital Equipment later said he didn't see why anyone would ever want a computer in her home. When Alexander Graham Bell invented the telephone, he was struggling and offered a half-interest in the telephone to the president of Western Union, who replied, "What could I do with an interesting toy like that?" Walt Disney's board of directors, his brother, and his wife didn't like Walt's idea to create Disneyland.

In the bull market from 2003 to 2007, two of the best leaders in 1998 and 1999, America Online and Yahoo!, failed to lead, and new innovators like Google and Priceline.com moved to the head of the pack. You have to stay in phase with the new leaders in each new cycle. Here's a historical fact to remember: only one of every eight leaders in a bull market reasserts itself as a leader in the next bull market. The market usually moves on to new leadership, and America keeps growing, with new entrepreneurs offering you, the investor, new opportunities.

A Look at Industries of the Past and What's Coming in the Future

At one time, computer and electronic stocks may outperform. In another period, retail or defense stocks will stand out. The industry that leads in one bull market normally won't come back to lead in the next, although there have been exceptions. Groups that emerge late in a bull phase are sometimes early enough in their own stage of improvement to weather a bear market and then resume their advance, assuming leadership when a new bull market starts.

These were the leading industry groups in each bull market from 1953 through 2007:

1953–1954	Aerospace, aluminum, building, paper, steel
1958	Bowling, electronics, publishing
1959	Vending machines
1960	Food, savings and loans, tobacco
1963	Airlines
1965	Aerospace, color television, semiconductors
1967	Computers, conglomerates, hotels
1968	Mobile homes
1970	Building, coal, oil service, restaurants, retailing
1971	Mobile homes
1973	Gold, silver
1974	Coal
1975	Catalog showrooms, oil
1976	Hospitals, pollution, nursing homes, oil
1978	Electronics, oil, small computers
1979	Oil, oil service, small computers
1980	Small computers
1982	Apparel, autos, building, discount supermarkets, military electronics, mobile homes, retail apparel, toys

1984–1987	Generic drugs, foods, confectionery and bakery, supermarkets, cable TV, computer software
1988–1990	Shoes, sugar, cable TV, computer software, jewelry stores, telecommunications, outpatient health care
1990–1994	Medical products, biotech, HMOs, computer peripheral/LAN, restaurants, gaming, banks, oil and gas exploration, semiconductors, telecommunications, generic drugs, cable TV
1995–1998	Computer peripheral/LAN, computer software, Internet, banks/finance, computer—PC/workstation, oil/gas drilling, retail—discount/variety
1999–2000	Internet, medical—biomed/genetics, computer—memory devices, telecommunications equipment, semiconductor manufacturing, computer—networking, fiber optic components, computer software—enterprise
2003–2007	Fertilizer, oil and gas, apparel, steel, medical, solar, Internet, home builders

As you might imagine, industries of the future create gigantic opportunities for everyone. While they occasionally come into favor, industries of the past offer less dazzling possibilities.

There were a number of major industries, mainly cyclical ones, that were well past their peaks as of 2000. Many of them, however, came back from a poor past to stronger demand from 2003 to 2007 as a result of the enormous demand from China as it copied what the United States did in the early 1900s, when we created and built an industrial world leader.

China, with its long border with Russia, witnessed firsthand the 70-year-old communist Soviet Union implode and disappear into the ash heap of history. The Chinese learned from the enormous growth and higher standard of living created in America that its model had far more potential for the Chinese people and their country. Most Chinese families want their one child to get a college education and learn to speak English. Families in India have many of the same aspirations.

Here is a list of these old-line industries:

1. Steel
2. Copper
3. Aluminum
4. Gold
5. Silver
6. Building materials

- 7.** Autos
- 8.** Oil
- 9.** Textiles
- 10.** Containers
- 11.** Chemicals
- 12.** Appliances
- 13.** Paper
- 14.** Railroads and railroad equipment
- 15.** Utilities
- 16.** Tobacco
- 17.** Airlines
- 18.** Old-line department stores

Industries of the present and future might include

- 1.** Computer medical software
- 2.** Internet and e-commerce
- 3.** Laser technology
- 4.** Defense electronics
- 5.** Telecommunications
- 6.** New concepts in retailing
- 7.** Medical, drug, and biomedical/genetics
- 8.** Special services
- 9.** Education

Possible future groups might include wireless, storage area networking, person-to-person networking, network security, palmtop computers, wearable computers, proteomics, nanotechnology, and DNA-based microchips.

Tracking Nasdaq and NYSE Stocks Together Is Key

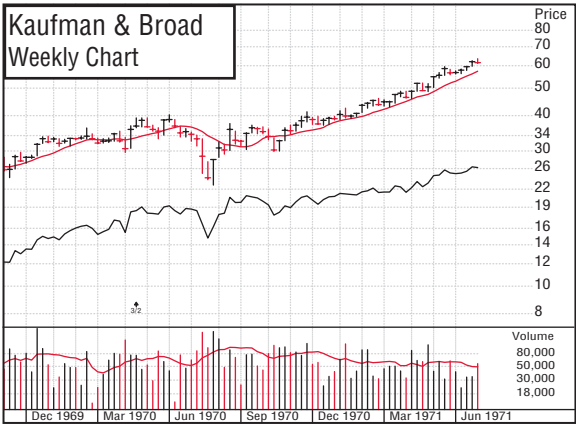
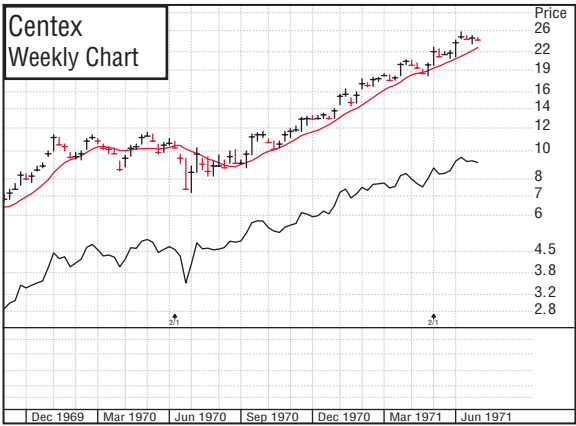
Groups that emerge as leaders in a new bull market cycle can be found by observing unusual strength in one or two Nasdaq stocks and relating that strength to similar power in a listed stock in the same group.

Initial strength in only one listed stock is not sufficient to attract attention to a category, but confirmation by one or two kindred Nasdaq issues can quickly steer you to a possible industry recovery. You can see this by looking at the accompanying charts of home builder Centex's OTC-traded stock

from March to August of 1970, and of home builder Kaufman & Broad's NYSE-listed shares from April to August of the same year:

- 1. Centex's relative strength in the prior year was strong, and it made a new high three months before the stock price did.
- 2. Earnings accelerated (by 50%) during the June 1970 quarter.
- 3. The stock was selling near an all-time high at the bottom of a bear market.
- 4. A strong Centex base coincided with the base in Kaufman & Broad.

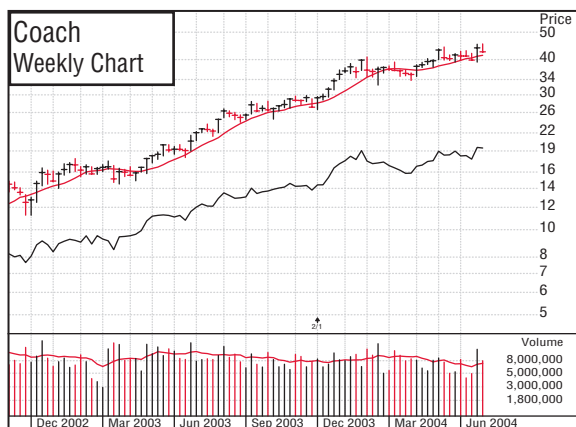
In the 2003 bull market, Coach (COH) was a NYSE-listed stock that we found on our weekly review of charts as it broke out of its base on February 28. It gave another buy point on April 25 when it bounced off its 10-week



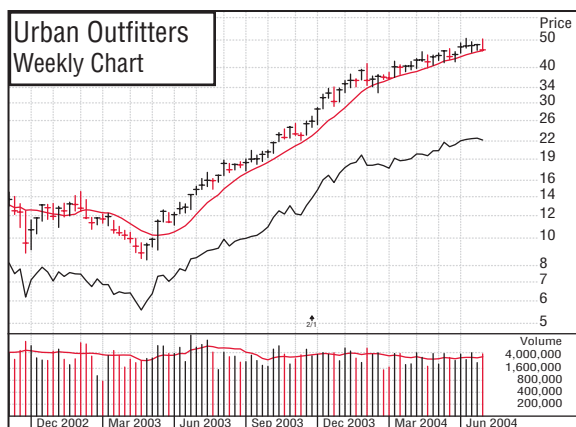
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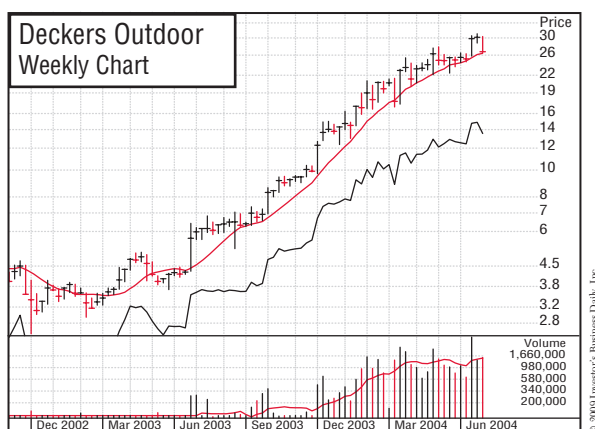
moving average price line. However, this time the new bull market had begun in earnest after a major market follow-through day in the market averages, and on April 25 two other leaders in the retail clothing industry—Urban Outfitters (URBN) and Deckers Outdoor (DECK)—broke out at the same time as the Coach move. Now there was plenty of evidence, from one NYSE stock and two Nasdaq issues in the same industry group, of a powerful new group coming alive for the new bull market that had just started. This is one more reason IBD's NYSE and Nasdaq tables are combined and the stocks are shown by industry sectors. You can spot all the leaders more easily when they're together in a group.



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A Key Stock's Weakness Can Spill Over to the Group

Grouping and tracking stocks by industry group can also help you get out of weakening investments faster. If, after a successful run, one or two important stocks in a group break seriously, the weakness may sooner or later “wash over” into the remaining stocks in that field. For example, in February 1973, weakness in some key building stocks suggested that even stalwarts such as Kaufman & Broad and MGIC were vulnerable, despite the fact that they were holding up well. At the time, fundamental research firms were in unanimous agreement on MGIC. They were sure that the mortgage insurer had earnings gains of 50% locked in for the next two years, and that the company would continue on its merry course, unaffected by the building cycle. The fundamental stock analysts were wrong; MGIC later collapsed along with the rest of the deteriorating group.

In the same month, ITT traded between \$50 and \$60 while every other stock in the conglomerate group had been in a long decline. The two central points overlooked by four leading research firms that recommended ITT in 1973 were that the group was very weak and that ITT's relative strength was trending lower, even though the stock itself was not.

Oil and Oil Service Stocks Top in 1980–1981

This same “wash-over effect” within groups was also seen in 1980–1981. After a long advance in oil and oil service stocks, our early warning criteria caused our institutional services firm to put stocks such as Standard Oil of Indiana, Schlumberger, Gulf Oil, and Mobil on the “sell/avoid” side, meaning we felt they should be avoided or sold.

A few months later, data showed that we had turned negative on almost the entire oil sector, and that we had seen the top in Schlumberger, the most outstanding of all the oil service companies. Based objectively on all the historical data, you had to conclude that, in time, the weakness would wash over into the entire oil service industry. Therefore, we also added equities such as Hughes Tool, Western Co. of North America, Rowan Companies, Varco International, and NL Industries to the sell/avoid list even though the stocks were making new price highs and showed escalating quarterly earnings—in some cases by 100% or more.

These moves surprised many experienced professionals on Wall Street and at large institutions, but we had studied and documented how groups historically had topped in the past. Our actions were based on historical facts and sound principles that had worked over decades, not on analysts' personal opinions or possibly one-sided information from company officials.

Our service is totally and completely different from that of all Wall Street research firms because we do not hire analysts, make buy or sell recommendations, or write any research reports. We use supply-and-demand charts, facts, and historical precedents that now cover all common stocks and industries from the 1880s through 2008.

The decision to suggest that clients avoid or sell oil and oil service stocks from November 1980 to June 1981 was one of our institutional firm's more valuable calls at the time. We even told a Houston seminar audience in October 1980 the entire oil sector had topped. A full 75% of those in attendance owned petroleum stocks. They probably didn't believe a word we said. We were not aware at the time, or even in the several months following, of any other New York Stock Exchange firm that had taken that same negative stand across the board on the energy and related drilling and service sectors. In fact, the exact opposite occurred. Because of such decisions, William O'Neil + Co. became a leading provider of historical precedent ideas to many of the nation's top institutional investors.

Within a few months, all these stocks began substantial declines. Professional money managers slowly realized that once the price of oil had topped and the major oil issues were under liquidation, it would be only a matter of time before drilling activity would be cut back.

In the July 1982 issue of *Institutional Investor* magazine, ten energy analysts at eight of the largest and most respected brokerage firms took a different tack. They advised purchasing these securities because they appeared cheap and because they had had their first correction from their price peak. This is just another example of how personal opinions, even if they come from the highest research places or bright young MBAs from

outstanding Ivy League universities, are quite often wrong when it comes to making and preserving money in the stock market.

The same situation repeated again in 2008 when we put Schlumberger on the sell/avoid list at \$100 on July 3. It closed below its 10-week average and fell to \$35 in eight months. Most of the oils were removed from our list on June 20th and they all slowly began their topping process as a group. Many institutions, on analysts' recommendations, bought the oils too soon on the way down because they seemed a bargain. Oil itself was midway in the process of collapsing from \$147 a barrel to its eventual low of \$35.

In August 2000, a survey showed many analysts had high-tech stocks as strong buys. Six months later, in one of the worst markets in many years, roughly the same proportion of analysts still said tech stocks were strong buys. Analysts certainly missed with their opinions. Only 1% of them said to sell tech stocks. Opinions, even by experts, are frequently wrong; markets rarely are. So learn to read what the market is telling you, and stop listening to ego and personal opinions. Analysts who don't understand this are destined to cause some substantial losses for their clients. We measure historical market facts, not personal opinions.

We do not visit or talk to any companies, have analysts to write research reports, or have or believe in inside information. Nor are we a quantitative firm. We tell our institutional subscribers who have teams of fundamental analysts to have their analysts check with their sources and the companies concerned to decide which of our rather unusual ideas based on historical precedent may be sound and right fundamentally and which are possibly not right. Institutions have always had a prudent personal responsibility for the stocks they invest in. We make our mistakes too, because the stock market is never a certainty. But when we make mistakes, we correct them rather than sit with them.

The Bowling Boom Tops in 1961

Beginning in 1958 and continuing into 1961, Brunswick's stock made a huge move. The stock of AMF, which also made automatic pinspotters for bowling alleys, gyrated pretty much in unison with Brunswick. After Brunswick peaked in March 1961, it rallied back to \$65 from \$50, but for the first time, AMF did not recover along with it. This was a tip-off that the entire group had made a long-term top, that the rebound in Brunswick wasn't going to last, and that the stock—as great as it had been—should be sold.

One practical, commonsense industry rule is to avoid buying any stock unless its strength and attractiveness are confirmed by at least one other

important stock in the same group. You can get away without such confirmation in a few cases where the company does something truly unique, but these situations are very few in number. From the late 1980s to the late 1990s, Walt Disney fell into this category: a unique high-quality entertainment company rather than just another filmmaker in the notoriously unsteady, less-reliable movie group.

Two other valuable concepts turned up as we built historical models in the stock market. The first we named the “follow-on effect,” and the second, the “cousin stock theory.”

The “Follow-On Effect”

Sometimes, a major development takes place in one industry and related industries later reap follow-on benefits. For example, in the late 1960s, the airline industry underwent a renaissance with the introduction of jet airplanes, causing airline stocks to soar. A few years later, the increase in air travel spilled over to the hotel industry, which was more than happy to expand to meet the rising number of travelers. Beginning in 1967, hotel stocks enjoyed a tremendous run. Loews and Hilton were especially big winners. The follow-on effect, in this case, was that increased air travel created a shortage of hotel space.

When the price of oil rose in the late 1970s, oil companies began drilling like mad to supply the suddenly pricey commodity. As a result, higher oil prices fueled a surge not only in oil stocks in 1979, but also in the stocks of oil service companies that supplied the industry with exploration equipment and services.

The roaring success of small- and medium-sized computer manufacturers during the 1978–1981 bull market created follow-on demand for computer services, software, and peripheral products in the market resurgence of late 1982. As the Internet took off in the mid-1990s, people discovered an insatiable demand for faster access and greater bandwidth. Soon networking stocks surged, with companies specializing in fiber optics enjoying massive gains in their share prices.

The “Cousin Stock” Theory

If a group is doing exceptionally well, there may be a supplier company, a “cousin stock,” that’s also benefiting. As airline demand grew in the mid-1960s, Boeing was selling a lot of new jets. Every new Boeing jet was outfitted with chemical toilets made by a company called Monogram Industries. With earnings growth of 200%, Monogram stock had a 1,000% advance.

In 1983, Fleetwood Enterprises, a leading manufacturer of recreational vehicles, was a big winner in the stock market. Textone was a small cousin stock that supplied vinyl-clad paneling and hollow-core cabinet doors to RV and mobile home companies.

If you notice a company that's doing particularly well, research it thoroughly. In the process, you may discover a supplier company that's also worth investing in.

Basic Conditions Change in an Industry

Most group moves occur because of substantial changes in industry conditions.

In 1953, aluminum and building stocks had a powerful bull market as a result of pent-up demand for housing in the aftermath of the war. Wallboard was in such short supply that some builders offered new Cadillacs to gypsum board salespeople for just letting them buy a carload of their product.

In 1965, the onrush of the Vietnam War, which was to cost \$20 billion or more, created solid demand for electronics used in military applications and defense during the war. Companies such as Fairchild Camera climbed more than 200% in price.

In the 1990s, discount brokerage firms continued to gain market share relative to full-service firms as investing became more and more mainstream. At that time, a historical check proved that Charles Schwab, one of the most successful discount brokerage firms, had performed as well as market leader Microsoft during the preceding years—a valuable fact few people knew then.

Watch for New Trends as They Develop

In our database research, we also pay attention to the areas of the country where corporations are located. In our ratings of companies as far back as 1971, we assigned extra points for those headquartered in Dallas, Texas, and other key growth or technology centers, such as California's Silicon Valley. Recently, however, California's high-cost, high-tax business environment has caused a number of companies to move out of the state to Utah, Arizona, and the Southwest.

Shrewd investors should also be aware of demographic trends. From data such as the number of people in various age groups, it's possible to predict potential growth for certain industries. The surge of women into the workplace and the gush of baby boomers help explain why stocks like The Limited, Dress Barn, and other retailers of women's apparel soared between 1982 and 1986.

It also pays to understand the basic nature of key industries. For example, high-tech stocks are $2\frac{1}{2}$ times as volatile as consumer stocks, so if you don't buy them right, you can suffer larger losses. Or if you concentrate most of your portfolio in them, they could all come down at the same time. So, be aware of your risk exposure if you get overconcentrated in the volatile high-tech sector or any other possibly risky area.

Sometimes Defensive Groups May Flash General Market Clues

It's also important for investors to know which groups are "defensive" in nature. If, after a couple of bull market years, you see buying in groups such as gold, silver, tobacco, food, grocery, and electric and telephone utilities, you may be approaching a top. Prolonged weakness in the utility average could also be signaling higher interest rates and a bear market ahead.

The gold group moved into the top half of all 197 industries on February 22, 1973. Anyone who was ferreting out such information at that time got the first crystal-clear warning of one of the worst market upheavals up to that point since 1929.

60% or More of Big Winners Are Part of Group Moves

Of the most successful stocks from 1953 through 1993, nearly two out of three were part of group advances. So remember, the importance of staying on top of your research and being aware of new group movements cannot be overestimated.

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• CHAPTER •

How I Use IBD to Find Potential Winning Stocks

Why We Created *Investor's Business Daily*

For decades, professional money managers were the only ones who had access to the in-depth data that are critical to finding winning stocks. In effect, they had a monopoly on relevant investment information. That's why I started *Investor's Business Daily* in April 1984: to bring the needed information to all investors, small or large, new or experienced.

Known for its investing capabilities as far back as the early 1960s, William O'Neil + Co. built the first computerized daily stock market database in the United States to track and compare stock performance. Detailed tracking uncovered key insights into what produces stock market winners, particularly their characteristics *before* they make a major price move.

Much of this information is now available through *Investor's Business Daily*, which offers everyone—professional and individual investors alike—a better opportunity to grow and profit from the detailed data. Because our primary concern is understanding and interpreting the national economy using our comprehensive database, *Investor's Business Daily* is a vital information provider first and a newspaper second.

If you're serious about becoming a more successful investor, it is positively within your grasp. If you can commit to studying the time-tested, historically proven strategies outlined in this book, being disciplined, and focusing on daily and weekly learning, you're more than halfway there. IBD's proprietary research tools are the other half of the equation. For many of you, this means familiarizing yourself with data, methods, and

concepts very different from those you're accustomed to hearing, seeing, and using.

For example, according to our historical study of all the greatest winning stocks, if you'd been relying on P/E ratios, you would have missed almost every major winner for decades. The information in IBD is based on the characteristics of the most successful companies of all time before their major price moves. Following these valid model examples of success has helped me and many others achieve success since the 1960s.

Investor's Business Daily began in April 1984 with only 15,000 subscribers. In the years prior to our launch, the *Wall Street Journal* grew steadily to reach its peak of 2.1 million domestic circulation by our 1984 introduction date. Since that time, *Investor's Business Daily* has increased its market share over many years. In key high-population areas such as southern California, Florida, and Long Island, New York, IBD has a larger than normal number of readers. While many of our readers were former *Wall Street Journal* subscribers, there is little current duplication of readership, since several surveys show that only 16% of IBD subscribers also take the *Journal*.

How *Investor's Business Daily* Is Different

So what is it exactly that distinguishes IBD from other sources? Let's take a closer look.

- **IBD makes it easier to search for winning stocks.** With more than 10,000 publicly traded stocks to choose from, IBD provides performance lists and proven proprietary fundamental and technical ratings and rankings that help you narrow your choices to only the very best opportunities.
- **It offers quicker, easier, and more accurate and reliable ways to interpret the general market.** The key elements of the day's trading action are explained in IBD's "The Big Picture" column to give you a sound perspective on the health of the overall market and improve your timing of buy and sell decisions. In tough markets like 2000–2003 and 2007–2009, this is critical information.
- **It provides you with valuable investing education and support.** IBD's entire focus is on solid database research and extensive historical model building to serve as examples—facts, not personal opinions. There are a multitude of sources outlined in this chapter that can help you learn and understand how the market really works, based on years of historical precedent.

A New, Better Way to Find Winning Stocks

At *Investor's Business Daily*, we've developed an entirely different way to search for winning stocks. That's because after more than four decades of historical research, we know top stocks show definite signs of strength before they become exceptional winners. That confuses people who prefer a bargain—the low-priced, unknown stocks they hope will take off and surprise us all. As we've said, cheap stocks are cheap for a reason: they have deficiencies that don't allow the stock to progress. For a stock to move higher, it needs earnings growth and strong sales, plus several other factors that demonstrate it's emerging as a new leader. If you catch such a stock at the early stages, you will be able to capitalize on its enormous progress.

Remember, the greatest winners of all time, like Cisco Systems and Home Depot, began their biggest price moves after they'd gained leadership in earnings, sales growth, and the other factors described in this book. Some of the critical data you need to start your search can be found in the IBD stock tables.

The unique IBD ratings are a way to spot potential winners before they take off, so it's important that you review these ratings daily. IBD's stock tables are different from anything you'll see anywhere else. Proprietary *SmartSelect* Corporate Ratings speak volumes about each stock's performance and how a stock compares to all the others in our database. The elements in these ratings, which are numbered 1 through 6 in the accompanying chart, are explained in detail here.

IBD Composite Rating										
Earnings Per Share Growth Rating										
Relative Price Strength Rating										
Sales+Profit Margins+Return On Equity										
Accumulation/Distribution (last 3 mos)										
52-wk	Dividend	Close	Vol%	Vol	P					
High	% Yield	Price	Chg	Chg	1000	E				
▼	▼	▼	▼	▼	▼	▼				

Common stocks above \$10 for Friday, March 27, 2009

1. MEDICAL										
⑤	①	②	③	④					⑥	
59	1	87	E	B-49.4	AMAGPhrm	AMAG	36.84	+.10	-55	167 ..0
90	88	76	B	B	30.6	Abaxis	ABAX	17.72	-.93	-4 267 31
85	84	67	A	D-60.8	AbbotLa	3.4 rABT	46.58	+.13	-5	11m 14%
48	50	33	D	D	79.0	AbraxisBn	ABII	44.38	-.88	-42 13 99
65	5	93	E	B-35.7	AcordaTh	ACOR	25.11	-1.16	-22	509 ..0
75	90	43	B	C	47.5	Aetna	.2 rAET	24.50	+.08	-14 6.2m 6%

The IBD *SmartSelect*® Corporate Ratings

The one line of information in the IBD *SmartSelect* Corporate Ratings is much more powerful and meaningful than anything you'll find in standard price tables. These ratings, which have been proven to be the most predictive measurements of a stock's possible future value, will narrow your search from over 10,000 stocks to the top investment prospects.

You'll find these ratings are like a condensed statistical summary financial report that looks at the fundamental strength or weakness of a stock. They are also a well-rounded evaluation of each company's general health. Most importantly, along with daily and/or weekly charts, these ratings will help you find better stocks. Let's examine each element.

Earnings per Share Rating Indicates a Company's Relative Earnings Growth Rate

Strong earnings growth is essential to a stock's success and has the greatest impact on its future price performance. The first absolutely vital component of the *SmartSelect* ratings is the Earnings per Share (EPS) rating, which is labeled 1 in the chart.

The EPS rating calculates the growth and stability of each company's earnings over the last three years, giving additional weight to the most recent few quarters. The result is compared with those of all other common stocks in the price tables and is rated on a scale from 1 to 99, with 99 being the best.

Example: An EPS rating of 90 means that a company's bottom-line earnings results over the short and the long term are in the top 10% of the roughly 10,000 stocks being measured.

This one number gives you the relative earnings performance for publicly held companies and the possible prospects for their stocks. It's an objective measure you can use to compare the audited results of one company to those of any other; for example, the earnings growth of IBM to that of Hewlett-Packard, Lockheed, Loews Companies, Wal-Mart, or Apple. Earnings estimates are not used in the calculation because they are personal opinions, which, as you know, might be wrong and do change.

Since earnings power and earnings growth are the most basic measures of a company's success, the EPS rating is invaluable for separating the true leaders from the poorly managed, deficient, and lackluster companies in today's tougher worldwide competition.

The EPS rating is also more meaningful than the widely followed Fortune 500 lists that rank corporations by company size. Size alone rarely guarantees innovation, growth, or profitability. Large companies that are

between 50 and 100 years old may have a well-known brand image, but often they are losing market share to younger, more innovative companies that have created newer, better products. Consider the decline of some of our auto companies and their unions, Alcoa, Eastman Kodak, International Paper, Xerox, CBS, Gannett, and Citigroup.

Relative Price Strength Rating Shows Emerging Price Leaders

Since we've learned that the best stocks are superior price performers even before their major moves, you should look for stocks with price leadership. The Relative Price Strength (RS) rating shows you which stocks are the best price performers, measuring a stock's performance over the previous 12 months. That performance is then compared with the performance of all other publicly traded companies and given a 1 to 99 rating, with 99 being best. Look at the column labeled 2 in the chart example.

Example: An RS rating of 85 means the stock's price movement has outperformed 85% of all other common stocks in the last year. The greatest winning stocks since 1952 and even much earlier showed an average RS rating of 87 when they broke out of their first price consolidation areas (bases). In other words, the greatest stocks were already outperforming nearly 90%, or nine out of ten, of all other stocks in the market *before* they made their biggest price gains.

Even in poor markets, a Relative Price Strength rating that breaks below 70 can forewarn you of a possible problem situation. On the sell side, however, we have a ton of sell rules that can lead you to sell most stocks sooner and more effectively than relying on a deteriorating relative strength line that is calculated using the past 12 months' price action. When you compare these fact-based performance ratings to the old, unscientific methods, which were typically based on faulty personal opinions, beliefs, academic theories, stories, promotions, egos, tips, and rumors, it becomes inarguable that IBD's unique factual ratings can give you a more clearheaded edge up in the complex market.

You Need Both Strong EPS and Strong RS Ratings

The implications of both the Earnings per Share rating and the Relative Price Strength rating are considerable. So far, you've been able to determine the top leaders in earnings and relative price strength. The vast majority of superior stocks will rank 80 or higher on *both* the EPS and the RS ratings *before* their major moves. Since one of these is a fundamental measurement and the other is a marketplace valuation, insisting on both numbers being strong should, in positive markets, materially improve your selection process.

Of course, there's no guarantee that a company's terrific past or current record won't suddenly turn sour in the future. That's why you must always use a loss-cutting strategy, such as the sell rules discussed in Chapters 10 and 11. It's also prudent and essential to check the stock's daily or weekly chart to see if it's in a proper base or if it's extended in price too far above its most recent area of consolidation. (For a review of common chart patterns to watch for, refer back to Chapter 2.)

As previously discussed, models of the best-performing companies over the last century showed that earnings growth for the last three years and percent increase in earnings per share for the latest two or three quarters were the two most common fundamental characteristics.

Having hard data like these available to you naturally begs the question, why would you ever invest your hard-earned dollars in a sluggish stock that sports a 30 EPS rating or a 40 RS rating when there are literally thousands of companies with higher ratings, including hundreds with superlative numbers?

It's not that companies with poor ratings can't perform. It's just that a greater percentage of them turn out to be disappointments. Even when a low-rated company has a decent price move, you'll find that the better-rated stocks in the same industry have probably done much better.

In a way, the combination of the EPS rating and the RS rating is similar to A. C. Nielsen's viewer ratings for TV shows. Who wants to continue sponsoring a TV show that gets poor ratings?

Now, pretend for a minute you're the manager of the New York Yankees. It's off-season, and you're going to pick new players for next year's team. Would you trade for, recruit, or sign only .200 hitters? Or would you select as many .300 hitters as possible? The .300 hitters cost you more money; their P/Es are higher, and they sell nearer to their price high. It's true the .200 hitters are available at a cheaper price, but how many games will you win with nine players in your lineup averaging .200? When the bases are loaded in the ninth inning and the score is tied, who would you rather see step up to the plate: a .200 hitter or a .300 hitter? How often does an established .200 hitter blossom into a batting champion?

Selecting and managing a portfolio of stocks is no different from baseball when it comes to performance. To win consistently and finish first in your division, you need a roster of the very best players available—those with proven records of excellence. You won't do as well in your investing if you insist on buying poorer performers and “cheaper stocks,” or those with some positive features but three or four little-noticed defects, in the hope of “discovering” a winner. Every little detail separates winners from losers. Hope never works in the market unless you start with a high-quality stock

that's begun to build steam. It's the "steam" (earnings, sales, and price and volume strength) that is the key prerequisite for future growth. Don't be fooled by bargain-basement thinking or buy stocks on the way down because they look cheap. Replace your hopes and fallible personal opinions with proven, measurable facts.

It's also interesting to note that these practical, no-nonsense ratings have helped to wake up corporate board members and put pressure on management teams producing second-rate results. A consistently low IBD relative performance rating should be a serious wake-up call to any top management team or board of directors.

Strong Sales, Profit Margins, and Return on Equity Are a Big Clue

Cutting costs may boost a company's earnings for a quarter or two, but powerful, sustained profit increases require healthy sales growth. It's also important to buy companies that make the most of their sales growth. How much profit do they generate from each dollar of sales? How well do they use their capital? The Sales + Profit Margins + Return on Equity (SMR[®]) rating combines these important fundamental factors and is the fastest way to identify truly outstanding companies with real sales growth and profitability. These are factors that are widely followed by the better analysts and portfolio managers. The SMR rating is on an A to E scale, with A and B being the best. In most cases, you want to avoid stocks with an SMR rating of D or E. See the column labeled 3 on the chart on page 342.

Example: An SMR rating of A puts a stock in the top 20% of companies in terms of sales growth, profitability, and return on equity. During the brief rally that followed the Nasdaq's bear market plunge from March to May 2000, SDL Inc. shot ahead as a leading performer. The maker of components for fiber-optic networks broke out to new highs just as the market confirmed a new uptrend, the most ideal situation for buying a stock. SDL Inc. ran up 112% in just eight weeks. Among its many strong qualities was an SMR rating of A.

For those who may not have always checked your stocks' return on equity, it's important. The table on page 347 of past leaders shows their ROEs.

Accumulation/Distribution—The Influence of Professional Trading on Stocks

Professional investors wield a huge amount of influence over a stock's price. Thus, it's essential that you buy the better stocks that mutual funds are buying and that you sell or avoid the ones they may be selling on a heavy basis. Trying to go against this monumental amount of trading will only hurt your results. A quick, efficient way to keep track of the end result of professional trading is to use IBD's Accumulation/Distribution Rating (the column labeled 4 on the chart on page 342), which is based on daily price and vol-

ROE of Past Leaders

Stock name	Return on equity at the time	Year an up move started	Percent increase to peak
Pic 'N' Save	28.7%	1976	2950%
Home Depot	27.8%	1982	958%
Price Co	55.4%	1982	1086%
Liz Claiborne	42.4%	1984	715%
The Limited	42.3%	1985	451%
This Can't Be Yogurt	41.2%	1985	2073%
Merck	19.8%	1985	870%
Microsoft	40.5%	1986	340%
Cisco	36.3%	1990	74445%
Intl. Game Tech	22.9%	1991	1691%
Nokia	30.9%	1998	8620%
Qlogic	18.8%	1998	3345%
America Online	36.3%	1998	481%
Charles Schwab	29.4%	1998	434%
Coach	43.1%	2002	625%
Chicago Mercantile Exchange	28.2%	2002	915%
Nextel Intl.	56.1%	2003	368%
Google	87.8%	2003	536%
Southern Copper	47.6%	2004	369%
C B Richard Ellis	26.4%	2004	220%
Hansens	43.6%	2004	751%

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ume changes. It tells you if your stock is under accumulation (professional buying) or distribution (professional selling). This thoroughly tested, complex, and proprietary formula is highly accurate and is not based on simple up/down volume calculations. Stocks are rated on an A to E scale, with each letter representing the following:

- A = heavy accumulation (buying) by institutions
- B = moderate accumulation (buying) by institutions
- C = equal (or neutral) amount of buying and selling by institutions
- D = moderate distribution (selling) by institutions
- E = heavy distribution (selling) by institutions

When a stock receives an A or B rating in *Investor's Business Daily*, it means that the stock is being bought on balance. However, this does not guarantee that it will go up. The buying activity is being picked up, but maybe the funds are buying into a questionable position, and what they are doing could be wrong. In some cases, stocks rated as D should be avoided. I would not buy a stock with an E rating. Later, however, if and when the market improves, it could change. C-rated stocks may be OK.

You needn't feel you've missed out on the trading action if you spot heavy buying or selling. Many funds take weeks or even months to complete their positions in a stock or rid themselves of those positions, which gives you time to capitalize on that action. However, be sure to check a daily or weekly stock chart to see if the stock is in the early, beginning stage of a move or if it is overextended in price and too risky or late to more safely buy.

Composite Rating: An Overview

The rating in the first column of the IBD stock tables is the *SmartSelect* Composite Rating, which combines all four *SmartSelect* ratings into a summary rating for quick review of overall performance. Look at the column labeled 5 (page 342). The *SmartSelect* Composite Rating formula is simple:

- Because of the impact of earnings and previous price performance on stock price, double weighting is given to both the Earnings per Share and the Relative Price Strength ratings. This weighting may change somewhat in the future as we continue to improve our ratings. Normal weight is given to the Industry Group Relative Strength, SMR, and Accumulation/Distribution ratings.
- The percent off the stock's 52-week high is also used in the *SmartSelect* Composite Rating.
- The results are then compared to the entire database, and a 1 to 99 rating (with 99 being best) summarizes the five most predictive measurements we've just discussed.

For some stocks, the *SmartSelect* Composite Rating may be higher than the four individual *SmartSelect* ratings. This is because the formula is weighted and includes the stock's percent off its 52-week high.

When you review the stock tables, this simple rating gives you an enormous time-saving edge. Work your way down the columns and look for *SmartSelect* Composite Ratings of 80 or better to spot the potential strong opportunities when you are in an uptrending general market.

The next step is to review all four individual *SmartSelect* ratings: EPS, RS, SMR and Accumulation/Distribution. With a quick scan of the stock tables, you're now that much closer to being sure you are selecting better stocks.

Volume Percent Change Tracks the Big Money Flow

Another important measurement IBD created is Volume Percent Change (see the column labeled 6 on page 342). Most newspapers and information providers on TV and the Web provide only a stock's trading volume for the day, which doesn't tell the entire, meaningful story. Based on the volume information they provide, how would you know whether the volume for all the stocks in your portfolio and those you're considering for purchase is normal, abnormally low, or abnormally high?

In order to know this, you'd have to keep in your head or on paper what the average daily volume is for each stock under review. Instead, you can rely on IBD to keep track of this key measure of supply and demand for you. IBD was the first to provide investors with a Volume Percent Change measure that monitors what the normal daily trading level for every stock has been over the most recent 50 trading days. It pays to always have the most relevant facts, not just a bunch of numbers.

Stocks trade at many different volume levels, and any major change in volume can give you extremely significant clues. One stock may trade an average of 10,000 shares a day, while another trades 200,000 shares a day, and still another trades 5 million shares a day. The key is not how many shares were traded, but whether a particular day's volume activity is or is not unusually above or below average. For example, if a stock with an average trading volume of 10,000 shares suddenly trades 70,000 shares, while its price jumps one point, the stock has increased in price on a 600% increase in volume—generally a positive sign as long as other market and fundamental measurements are constructive.

If this happens, the Volume Percent Change column will show a +600%, which quickly alerts you to possible emerging professional interest in the stock. (In this case, the stock is trading 600% above its normal volume, and if the price is up substantially all of a sudden; this can be a major tip-off.) Volume Percent Change is like having a computer in your pocket to carefully monitor the changing supply and demand for every single stock. Where else can you get such preeminently critical data?

Almost all daily newspapers have cut out essential information in their stock tables. This includes the *Wall Street Journal*, which no longer even shows a stock's trading volume in its daily stock tables.

Volume Percent Change is one of the main reasons so many specialists on the floor of the New York Stock Exchange, professional portfolio managers, top-producing stockbrokers, and savvy individual investors use and refer to IBD's stock tables. There is no better way to track the flow of money into and out of companies, if you know how to utilize these data. If price is all you look at when you check your stocks, you're like a piano player who plays with only one hand,

uses only one finger, has never heard of a chord or foot pedal, or doesn't read sheet music, so he never knows when to speed up, get loud, or get softer.

Investor's Business Daily is more than a newspaper. It's also a gigantic radar set that monitors every variable that's important to the successful investor. And it lays all the information out for you daily, both in print and electronically, with the version that's available on the Internet.

The electronic version lets you have the information sooner—within hours after the market closes. Investors who like to prepare for the next trading day find this especially convenient. Others prefer a paper they can carry with them, make notes on, and use as a valuable guidebook.

How to Use *Investor's Business Daily*

Whether she uses the print or the electronic version (or both), each reader probably has a different way of reading the paper. My preference is to start with the front page and then proceed page by page to the end.

Front Page Comes First

The first feature I check on the front page is the short, quick market summaries at the top, above the paper's nameplate. These show price and volume changes for the S&P 500 index, the Dow Jones Industrials, and the Nasdaq, plus brief, two-line comments on market highlights. Brief notes on fixed income, currency, and commodities are also shown.

For example, the comment under NYSE volume reads, "Volume above average, up from previous day." In 40 seconds I look at these briefs to make sure I didn't miss anything important from the day's action.

S&P 500 INDEX	DOW JONES IND.	NYSE VOL. (MIL)	NASDAQ	NASDAQ VOL. (MIL)
845.85	8063.07	1,619	1546.24	2,549
+13.62 (+1.6%)	+106.41 (+1.3%)	+230 (+16.5%)	+31.19 (+2.1%)	+324 (+14.6%)
MasterCard, Akamai explode on upside	GM, Wal-Mart Stores lead blue chip rally	Volume above average, up from previous day	50-day line retaken; chips up for fourth day	Best upside volume since Nov. 21 low

"IBD's Top 10" Stories

The second thing I read on page 1 is "IBD's Top 10," a quick, time-saving way to stay informed. In briefs of only seven to nine lines each, the ten most important new stories are summarized. Today, for example, the number two story tells how same-store sales were down last month at most retail chains, but Wal-Mart's were not only up but better than expected. In the number three spot is "Senate Nears Vote On Stimulus," an update on Congress's efforts to come up with an economic recovery plan.

The Big Picture

The third feature I always check on page A1 is the “The Big Picture” column at the bottom. It’s a fairly short but excellent summary of market action and key developments. Inside the column is “Market Pulse,” a valuable box that notes leaders that were up in volume for the day and those that were down. The pulse also lets you know whether the market’s in an uptrend or a declining phase.

“The Big Picture” column is one of IBD’s most highly read features. Dedicated readers have repeatedly told us it has helped them immeasurably in dissecting the general market. In fact, more than a thousand have given testimonials on how it has helped them raise cash when the market began getting difficult or determine when it was starting a major uptrend.

THE BIG PICTURE

Stocks Back Off, But Close With Gains For 3rd Week

BY DONALD H. GOLD
INVESTOR'S BUSINESS DAILY

Stocks ended the week with losses across the board on disappointing economic data and some dour comments from the country's biggest bankers.

The Nasdaq and NYSE composite each tumbled 2.6%, the S&P 500 fell 2% and the Dow lost 1.9%. Losers hounded winners by about 3-to-1.

Volume fell on both major exchanges, providing a bit of relief.

What's more, there were no great collapses by the market's best stocks, and few fell substantially in high volume.

MARKET PULSE

Friday's action:

Profit-taking pushes market lower, but volume also drops

Current outlook:

Market in confirmed rally

Distribution days:

1 for S&P 500, Nasdaq, Dow, NYSE composite

Leaders down in volume:

AccentureTM Longtop
Financial Technologies^{PT}
ViaSatSM Tetra TechTM

of 2% or 2.6% would be an awful lot. But the market is still volatile.

treated, and rose as the market climbed. No distribution days were logged.

The market closed at or very near the day's high twice, once Monday and again Thursday.

The distribution-day count has fallen for the Nasdaq and S&P 500, to one from two.

Why? The market has climbed more than 10% from the March 16 session, the first distribution day since the March 12 follow-through. As the market rises farther from that bad day, that distribution is less dangerous to the overall uptrend.

Somewhat troubling, the IBD 100 only climbed 4.4% for the

far above average in the morning, but had cooled off by day's end.

Monro Muffler Brake^{AMMO} fell 7% in busy trade. The chain of service centers and tire shops ended a three-week winning streak.

In economic news, February personal income fell 0.2%, a bit worse than expected. Personal spending rose 0.2%, following January's 1% increase.

The personal consumption expenditure deflator, said to be the Fed's favorite inflation guide, rose 1% in February, higher than expected. Core PCE gained 1.8% in February, topping forecasts.

The Reuters/University of Michigan final index of consumer senti-

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Top Stories

Finally, I glance at the headlines on the main two front-page stories. I'm a headline reader: if a story is on a subject I want to know about, I read it; if not, I skip it and go to the next page.

The top stories will often show charts or tables. The one I'm looking at has a table of 15 retailers. It shows sales changes for the month plus same-store results and estimates for the future. This quickly tells me three companies in the field are doing excellently, but many others aren't.

To The Point

Page 2 saves a busy executive or investor time. Titled “To The Point,” it provides some 50 business briefs, arranged by industry sector, and short summaries on the nation, the world, and the economy. I can quickly scan each headline and read the briefs I'm interested in. There's also a column called “Trends and Innovations” that I always try to read to learn about the new things that keep being invented in today's society.

In the middle is a feature that's particularly valuable to the investor: a half-dozen short stories about companies that reported earnings after the close and how the market reacted in after-hours trading. This is a fast way to make sure you didn't miss anything after the market close.

Leaders & Success

"Leaders & Success" on page A3 is a unique feature that's been in the paper since we started. I always read "Wisdom to Live By"—the short two- or three-line quotes from famous people at the top of the page.

Many people find inspiration on this page. It's about people who have been immensely successful: what they did and how they did it, what they believed in and how they overcame the problems they faced along the way.

10 Secrets To Success

Another element on the page is called IBD's "10 Secrets To Success." A lot of parents teach this to their kids by having them read these little short stories. The 10 secrets start with "How You Think Is Everything: Always Be Positive. Think Success, Not Failure. Beware of a Negative Environment." The second is "Decide upon Your True Dreams and Goals: Write Down Your Specific Goals and Develop a Plan to Reach Them." The third is "Take Action: Goals Are Nothing without Action. Don't Be Afraid to Get Started. Just Do It." The fourth is "Never Stop Learning: Go Back to School or Read Books. Get Training and Acquire Skills." And so on, until you get to the last one, which is "Be Honest and Dependable; Take Responsibility: Otherwise, Nos. 1–9 Won't Matter."

Below the list, one of the 10 secrets is discussed in detail each day. Parents find this is something their children don't get in school, and they use it to help them learn the basic principles of how to succeed in life.

Rounding out the "Leaders & Success" page are two profiles of outstanding people, past and present, and how they succeeded.

Internet & Technology

The next page focuses on "Internet & Technology." Some investors don't spend much time here. But if tech stocks are leading the market, you want to read this section to be on top of the discussions. We have a bureau in Silicon Valley staffed by experienced reporters who've been with us many years. The page they put together is designed not only for investors but for anyone in the tech industry—computer programmers, engineers, systems people, and others.

We have a subscriber who works at a big outfit the government uses to research how inventions might be applicable to defense efforts. One of the

firm's top researchers has found that our writers get their facts straighter and understand the technologies better than those on most of the business magazines. We also have CEOs of computer software companies that subscribe to IBD.

Your Weekly Review

There is a feature in the first section called "Your Weekly Review." It includes a table of 35 stocks showing strong weekly gains and a chart on each one. It also includes a story on some of the companies. In a recent story, Paul Whitfield tells how the stocks of Netflix, Edwards Life Sciences, Matrix Initiative, and McDonald's are all acting in a superior way accompanied by interesting news.

Inside Real Estate

The next page I turn to is "Inside Real Estate." I don't normally read this, but somebody who is interested in the real estate market certainly should.

The New America

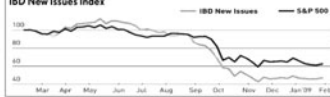
Next is "The New America" page, devoted to young, entrepreneurial companies. One company gets extensive treatment each day. At the top of the page, we sometimes have short briefs under the heading "AfterMarket." The one I'm looking at is headlined "Neutral Tandem Soars on Q4 Results." It notes that "telecom gear maker Neutral Tandem gapped up 11% in more than seven times average volume" and then quotes what ana-

AFTERMARKET

Neutral Tandem Soars on Q4 Results

Telecom gear maker Neutral TandemTM gapped up 11.1% in more than seven times average volume Thursday to close at \$7.54. The firm beat analysts' views for the fourth quarter and delivered high guidance for first-quarter sales. Neutral Tandem went public in Nov. 2007 and peaked at 23 a year ago.

IBD New Issues Index



Leading New Issues

Company	Date	Offering	Current % change	QPS	Q4	Industry group	Lead underwriter
Lead underwriter	1/23/09	1.5	1.5	1.5	1.5	Lead underwriter	Lead underwriter
Energy Services Inc.	1/23/09	1.5	1.5	1.5	1.5	Energy Services	Energy Services
Chow Hing Kee Ltd.	1/23/09	1.5	1.5	1.5	1.5	Food & Beverage	Chow Hing Kee Ltd.
First State Capital	1/23/09	1.5	1.5	1.5	1.5	Financial Services	First State Capital
Chow Hing Kee Ltd.	1/23/09	1.5	1.5	1.5	1.5	Food & Beverage	Chow Hing Kee Ltd.
Chow Hing Kee Ltd.	1/23/09	1.5	1.5	1.5	1.5	Food & Beverage	Chow Hing Kee Ltd.
Chow Hing Kee Ltd.	1/23/09	1.5	1.5	1.5	1.5	Food & Beverage	Chow Hing Kee Ltd.
Chow Hing Kee Ltd.	1/23/09	1.5	1.5	1.5	1.5	Food & Beverage	Chow Hing Kee Ltd.

THE NEW AMERICA

KINROSS GOLD CORP., Toronto, Ontario

Rising Prices And New Mines Drive Growth For Canadian Gold Miner

BY MARILYN ALVA

INVESTOR'S BUSINESS DAILY

Gold is looking shiny from a couple of angles.

It's seen as a hedge against economic hardship and a good investment when inflation returns.

Though volatile, shares of major gold miners have performed relatively well as gold prices have risen the past few years.

One of them is Canada's Kinross GoldTM, which has benefited from rising production and prices.

Three new mining projects started or expanded last year in Russia, Brazil and Washington state are expected to boost Kinross' production by 32% this year vs. 2008, to between 2.4 million and 2.5 million gold equivalent ounces.

Kinross is boosting production at a time when supply is shrinking. Global production of gold — a finite resource — has been declining for years as mines mature and supply



Work at Washington state's Buckhorn mine, one of three growth projects that has helped Kinross Gold.

Kinross Gold

kinross.com

Ticker

Share price

12-month sales

5-year profit growth rate

IBD New Issues Corporate Ratings

Composite Rating

Earnings Per Share

Statistical Price Strength

Industry Group Rank

Sales/Profit Margins/ROE

Accumulation/Contribution

See kinross.com for more details

in the face of the global meltdown, ranging between \$700 and \$1,000 ounce the past year. Since mid-January, prices have risen to above \$900 an ounce from the mid-\$800 range.

"We're in a deflationary environment now, but if inflation kicks up, gold prices will likely push up to \$1,000 or more," analyst Bridges said.

Gold, he says, could continue to rise if investors lose confidence in

forecast for 2009 to \$1,000 an ounce.

However, gold stocks might fall some even if prices stay high. Bridges warns. When investors have enough confidence that the economy is under control and moving in the right direction, money will likely flow back into other types of stocks, he says, putting pressure on gold equities. But that could take a while.

For now, growth in demand for gold as an investment has somewhat offset slowing demand for gold jewelry — particularly in India, a big jewelry-consuming nation hit by a plummeting stock market.

Low Costs Help

Kinross is one of the lowest-cost producers in the industry. That gives it "good insurance against volatile gold prices," Burr said. Lower fuel costs also help.

In the third quarter, Kinross' cost of sales per ounce of gold equivalent

lysts are saying. When these tidbits of unusual activity catch my attention, I'll check them out on my computer and view a chart to see how the stock really looks.

You never know how many ideas you're going to pick up from reading IBD. But in each issue, there will be several you'll want to check out. It takes no time at all to go to your PC, punch in the symbol that appears in the paper right alongside the first mention of the company's name, and check into the history of the stock, its earnings, and a few other key basics. Some of the best portfolio managers in the country quickly check out stocks this way to decide which companies they want to focus on or get more information about. It's a good way to add to your watch list.

Mutual Funds & ETFs

On the first page of the "Mutual Funds & ETFs" section, there are two information boxes I usually check. They zero in on growth funds with excellent records. The boxes show these funds' largest holdings in the latest quarter, along with their top new buys and sells. New buys may be of interest. We also show how the funds have performed relative to the market in each of the last five years. After you've taken the paper for a while, you'll know which are the better funds. One way you can judge is by noting their top positions. If the fund has three or four of the better leaders, I know the managers really know what they're doing.

I don't normally look at our mutual fund tables, but I will frequently check one or two fund families that I know are outstanding to get a feel of how they're doing. We cover far more funds and include more data in our tables than most daily publications. Many papers have sharply cut the num-

Mutual Fund Performance

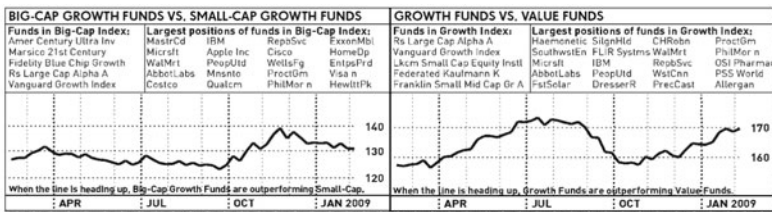
36 Mos Performance Rating/Ten	4 Wk Net % Asset NAV Chg/Value/Chg	36 Mos Performance Rating/Ten	4 Wk Net % Asset NAV Chg/Value/Chg	36 Mos Performance Rating/Ten	4 Wk Net % Asset NAV Chg/Value/Chg	36 Mos Performance Rating/Ten	4 Wk Net % Asset NAV Chg/Value/Chg		
For Thursday, March 19, 2009									
-A-									
Access Capital Strat									
\$ 536 mil 677-2274		B- Wilshireb	0 5.70 +05	C+ Growth	0 15.43 +03	C Inco Fed Ann	0 11.66 +04		
Commodities +1 9.58		E Intl Growth	+2 9.15 +04	B- Income	0 21.50 +03	D Inv Co Ann	+1 18.70 +05		
Advance Cap I		E Intl Val	+4 8.70 +10	Amor Cent A					
\$ 514 mil 800-345-4993		D+ Lrg Cap Grow	+1 15.01 +15	\$ 3.9 bil 800-345-2021		D+ Mutual	+1 17.00 +05		
B- Redstone Inc -1 7.35 -02		A- Muni Cal	+1 10.02 +09	A- Divers Bnd	+1 10.29	A- US Gov Sec	+1 14.70 +01		
AdviserOne Funds		B- Muni Natl	0 9.00 +07	C Equity Inc	0 5.35 -02	D Wash Mt	+1 18.00 +13		
\$ 542 mil 866-411-0225		A- Muni NY	-1 9.24 +07	C ShalokMed	+1 4.60 +03	American Funds A			
E Amerigo N +3 7.75 +03		E Wroth Aggr	+2 7.21 +06	Amor Cent Adv					
AIM Funds A		Alliance Bndsto Adv							
\$ 112 bil 800-999-4246		\$ 2.8 bil 800-221-5672		\$ 1.4 bil 800-345-2021		\$ 4.6 bil 800-471-4020			
E Basic Valueb +2 11.60 +21		E Intl Val +4 8.63 +10		A Infrnt Adj	+3 10.90 +05	C Balanced	+3 11.24 +02		
E Cap Dvlpb +2 9.21 +06		E Wroth Aggr +2 7.22 +06		\$ 5.2 bil 800-345-2021		B Bld Fed Ann	+1 12.54 +08		
E Charterb +1 10.52 +12		Alliance Bndsto B				C Capthd Bnd	0 27.73 +01		
E Consttutb +6 14.93 +17		\$ 2.8 bil 800-221-5672		A- Divers Bnd	+1 10.29	C Capthd Gbl	+2 23.60 +05		
C Devlp Mktb +6 15.23 +19		D+ Bld Wrothx +1 7.73 +13		C Equity Income	0 5.36 -02	A- Capthd Gbl	+2 18.34 +18		
C Euro Growth +5 10.32 +10		Alliance Bndsto C		C ShalokMed	+1 4.60 +03	C EuroPac Gr	+3 25.42 +11		
C GlblMktCareb -8 18.42 +35		\$ 2.7 bil 800-221-5672		Amor Cent Inv					
D GlblMktGldr +3 10.16 +04		E GlblRctrtx +5 4.96 +11		\$ 34.8 bil 800-345-2021		D Fundmentl	+3 23.03 +09		
C Intl Growth +2 17.38 +03		E GlblWrothx +1 7.70 +13		A- CA Lrg Intfr	+1 8.10 -04	D Gr Fed Amer	+3 19.39 +01		
D Lrg Cap Gld -2 7.54 -01		B+ GlblBond -1 6.58 +02		C Balanced	0 13.20 +01	B High Inc Muni	0 23.01 +05		
C Mid Cap Eqb +1 14.60 +14		Alliance Bndsto I		C CAH Yld	-1 8.45 +05	C High Income	+2 7.71 +02		
A- Muni Bondb 0 7.55 +05		\$ 4.7 bil 800-424-0107		A- CA Lrg Intfr	+1 10.29 +05	C Inco Fed Amer	0 11.34 +04		
E Real Estateb +5 10.32 +10		E NF Jbr Val x -1 7.50 +17		A CA Fedrebb	+1 10.70 +05	IntnlGldnc	+3 21.15 +07		
D Sml Cap Gld +2 15.49 +07		B+ IntlVal x +4 8.76 +11		A- Divers Bnd	+1 10.29	D Inv Co Ann	+2 18.70 +05		
A- USGovt -2 9.09 -02		B+ Intlntd Dst -1 13.20 +02		D- Equity Grow	+2 12.19 +01	A US Gov Sec	+1 14.71 +01		
		Alliance A		C Equity Inc	0 5.35 -02	C Mutual	+1 17.17 +04		
		\$ 4.7 bil 800-424-0107		C Glttst	+1 15.92 +14	D New Econ	+3 14.70 +06		
		E NF Jbr Val x -1 7.50 +17		A- Glbl Mkt	+1 10.63 +01	C New Pers	+2 17.31 +03		
		B+ Intlntd Dst -1 13.20 +02		C Glbld Eq	+5 15.70 +34	C New World	+4 20.99 +13		
		C NF SmlCapGld -1 16.29 +03		A- Govt Bond	+1 11.20 +01	StorMntd	0 9.09 +02		
				C Growth	+1 15.30 +01	Sml Cap Wld	+2 18.96 +05		

ber of funds they follow. Besides current activity, we include the four-week percentage change and a 36-month performance ranking for each fund. We also include the phone number for each fund family.

A couple of tables in the fund section are unique. One shows how big-cap growth funds are doing compared with small-cap growth funds. The other compares growth funds to value funds. This is important for you to know in any market: Are growth stocks leading, or are value stocks? Are big caps leading, or are small caps? Here you have the answers at a glance. In the edition I have, growth is leading.

Leading Fund Sectors

You also need to know the broad, overall sectors that are in demand. So, on Fridays we have two tables showing the top industry and sector funds. On other days, different fund types are displayed. If you're interested in what industries are doing well, you can see here that gold has been doing well in



Top Industry & Sector Funds

Best % change in last 4, 8 & 12 weeks on a total return basis.
★ indicates fund is on 3 different weeks' lists.

Mutual Fund	% Change	\$ Net Assets
Best % Change Last 4 Weeks:		
Amer Cent Inv Gbl Gold Eq	★ + 9	719 mil
Van Eck Intl Gold A	★ + 9	436 mil
Tocqueville Gold	★ + 9	555 mil
Fidelity Sel Med Eq & Sys	+ 8	1.1 bil
First Eagle Gold A	+ 7	726 mil
Fidelity Sel Medcl Dlvry	+ 7	265 mil
Best % Change Last 8 Weeks:		
US Glob Inv WrldMineral	+ 31	292 mil
Van Eck Intl Gold A	★ + 29	436 mil
USAA Prcs Metals	★ + 28	879 mil
Tocqueville Gold	★ + 27	555 mil
Rydex Investor Prec Metals	★ + 26	149 mil
Oppenheimer A Gold&SpMin	+ 25	1 bil
Best % Change Last 12 Weeks:		
USAA Prcs Metals	★ + 56	879 mil
Van Eck Intl Gold A	★ + 56	436 mil
Amer Cent Inv Gbl Gold Eq	★ + 55	719 mil
Rydex Investor Prec Metals	★ + 54	149 mil
Tocqueville Gold	★ + 51	555 mil
Frank/Tmp Fr A Gold & Prec	+ 50	878 mil

Top Industry & Sector Funds

Best % change in last 16 & 39 weeks on a total return basis.
★ indicates fund is on 3 different weeks' lists.

Mutual Fund	% Change	\$ Net Assets
Best % Change Last 16 Weeks:		
Van Eck Intl Gold A	★ + 40	436 mil
Amer Cent Inv Gbl Gold Eq	★ + 39	719 mil
USAA Prcs Metals	★ + 37	879 mil
Fidelity Sel Gold	+ 36	1.7 bil
Evergreen A PreciousMtl	+ 35	420 mil
Tocqueville Gold	★ + 34	555 mil
Oppenheimer A Gold&SpMin	+ 34	1 bil
Gamco AAA Gold	+ 32	367 mil
Frank/Tmp Fr A Gold & Prec	+ 31	878 mil
DWS Scudder S Gold & Prec	+ 30	227 mil
Rydex Investor Prec Metals	★ + 29	149 mil
US Glob Inv GblGoldMtl	+ 26	154 mil
Best % Change Last 39 Weeks:		
Eaton Vance A WW HthSci	+ 1	887 mil
Frank/Tmp Fr A Biotech Dsc	+ 1	291 mil
Fidelity Sel Biotechnlgy	- 1	1.2 bil
Putnam A GblHthCre	- 10	996 mil
Vanguard Health Care	- 10	10.8 bil
Blackrock A HealthSciOp	- 10	418 mil
Fidelity Sel Pharm	- 13	166 mil
First Eagle Gold A	- 14	726 mil
Schwab Health Care	- 14	523 mil
FBR SmFinl Inv	- 15	180 mil
Fidelity Sel Med Eq & Sys	- 16	1.1 bil
ICON Healthcare	- 17	147 mil

the last 4-week, 8-week, 12-week, and 16-week periods. The medical field shows well in the longer, 39-week table.

Issues & Insights

At the back of the first section, you'll find our editorial pages, titled "Issues & Insights." We have an outstanding staff of a half-dozen highly experienced writers turning out up to six editorials a day. I do not write these. Wes Mann, our distinguished and talented editor, who has been with IBD from the beginning, is in charge of this key area and is assisted in the important role it plays for IBD readers and the nation by Terry Jones, who has also been with IBD since its start-up 25 years ago. Terry came to us from *BusinessWeek*. I'll normally read two or three of the editorials after checking the headlines and summary paragraphs to see if I'm interested in the subject.

We also have columns from guest writers plus syndicated columnists "On the Left" and "On the Right," so you get different points of view. On the right, I always respect the work of Thomas Sowell and Victor Davis Hanson. Both are older, experienced observers with great insight. Sowell, from Stanford's Hoover Institute, is in my view the best, most accurate economist and historian in America. He has a book out entitled *Applied Economics: Thinking beyond Stage One*, one of 42 books he has written. From Washington, we run columns by conservative Charles Krauthammer and liberal David Ignatius, who is well informed on international issues.

But the first thing I look at each day in "Issues & Insights" is the cartoon. We have the best editorial cartoonist in the nation, Michael Ramirez. He won a Pulitzer Prize for *Investor's Business Daily* in 2008—the second time he had received this prestigious award.

IBD also has an extensive public polling operation, conducting monthly surveys on economic confidence, presidential leadership, and major national issues year-round and daily tracking polls in election years. In 2008, for the second presidential election in a row, the IBD/TIPP poll not only came closest to the final margin between Barack Obama and John McCain, but was right on the money. These feats, tantamount to hitting a bullet with a bullet, have earned the IBD/TIPP poll, conducted by TechnoMetrica Market Intelligence, the honor of being America's most accurate.

Making Money

In the "Making Money" section, starting on page B1, we try to cover the relevant facts, skills, and rules you need if you are to be a successful investor. We view *Investor's Business Daily* as an educational medium. We don't tell people what to buy. We don't recommend stocks or tout "10 stocks that are going to go up tomorrow." We just explain time-tested rules based on mod-

els of successful stocks in all of past history and provide sound techniques and methods for managing your portfolio wisely.

We also give classes and several levels of paid workshops, from beginning to very advanced, on investing; in addition, we have a chart school, have several books out, including this fourth edition of the one you're reading, and offer a home study course. We view our mission as being to teach anyone who wants to learn how to become a better investor and protect himself so he doesn't get hurt in bear markets.

NYSE + Nasdaq Stocks On The Move

The first thing I read on page B1 is the "NYSE + Nasdaq Stocks On The Move" tables—a feature that's in no other publication. We have a massive computer database that each day screens for those stocks that had the greatest increase in trading volume over and above their average daily volume in the last three months. This isolates the true demand for securities you would not otherwise notice. On these lists, you'll find many new, innovative companies with names you may not know. But if they appear frequently, you'd better find out what they're doing or making. They could be the next Microsoft or Apple.

In this current issue, Visa is on the NYSE list. It was up 4.6 points on a volume increase to 239% more than normal for the credit card company. Visa just reported earnings during a bearish period. There were also a few medical stocks on the lists.

In addition to price and volume change, the tables show the same company variables IBD shows in its main stock tables. For example, IBD shows the Earnings per Share rank of Visa as 99, meaning its earnings growth rate in the last three years and in recent quarters puts it in the top 1% of all companies in our database. This doesn't mean the stock's going to go up. But it certainly means it has characteristics worth checking if you're hunting for entrepreneurial stocks that might outperform in a future better market.

We boldface those names on this list that have Earnings per Share and Relative Strength ratings of 80 or higher, meaning they're in the top 20% of all stocks based on those measurements. The stocks with stronger records are the ones you want to investigate.

Below the list of stocks that advanced for the day is a list of stocks that were down in price. They too are ranked by percentage increase in volume. You can judge the market environment and how well our new government is doing by how many stocks are on the upside versus how many are on the downside. In the example shown, the table has eight NYSE stocks on the upside versus 36 on the downside, meaning there were more stocks that day with greater-than-normal volume that dropped in price than that increased

NYSE + Nasdaq Stocks on the Move

Stocks with high volume vs. 50-day avg., reflecting heavy institutional action. 80 EPS & 80 RS or better are **boldfaced**.

SMARTSELECT® COMPOSITE RATING											SMARTSELECT® COMPOSITE RATING												
EPS Rel Acc 52-Wk					Stock					EPS Rel Acc 52-Wk					Stock								
▼	Rnk	Str	Dis	High	NYSE Stock	Symbol	Price	Chg	Vol	Vol%	▼	Rnk	Str	Dis	High	Nasdaq Stock	Symbol	Price	Chg	Vol	Vol%		
	94	99	76	B-	89.84	Visa n	V	53.74	+4.61	24,135	+239		98	99	86	B	23.00	NeutTand n	TNDM	17.74	+1.77	1,583	+818
	94	94	75	B-	37.40	Aeropostl	ARO	22.81	+1.68	4,176	+53		85	82	82	D+	45.00	Blkboard	BBBB	29.01	+4.68	1,951	+532
	96	86	87	C	29.11	AtmosEngy	ATO	25.40	+0.77	810	+42		99	96	95	B-	31.05	TowrGp	TWGP	26.78	+1.80	1,860	+382
	91	95	95	B-	87.88	CmpsMn	CMP	63.45	+1.57	969	+30		99	91	90	A-	64.47	ShireLtd	SHPGY	46.14	+0.57	1,763	+179
	92	96	72	B	105.1	NobleEnr	NBL	53.44	+1.47	3,044	+18		88	85	86	C+	41.56	RossSts	ROST	30.63	+2.38	5,257	+135
	99	99	98	B	59.45	Sc0mMra	SOM	29.30	+0.72	1,134	+15		99	75	99	B-	85.40	MyriadGn	MYGN	83.61	+0.50	1,469	+62
	97	91	74	D+	60.00	ITCHldgs	ITC	42.57	+0.80	552	+15		99	95	99	D+	45.07	LifePtnrs	LPHI	38.91	+2.47	196	+52
	99	91	94	B+	52.00	MedcoHlth	MHS	48.50	+1.77	3,832	+10		99	96	91	B-	73.59	Biognldc	BIBB	53.28	+0.53	4,843	+31
	48	45	57	C+	40.75	I D E X Corp	IEK	21.51	-1.56	2,874	+399		94	99	91	B-	144.3	Priceline	PCLN	72.67	+1.91	1,779	+29
	80	83	70	B-	50.04	RegalBel	RBC	31.07	-1.92	1,689	+345		98	75	89	B	47.96	AlexionPhr	ALXN	39.18	+1.36	1,046	+23
	57	53	49	C+	35.81	SonocoP	SON	20.47	-3.22	2,433	+247		97	75	99	C+	24.08	Crucell	CRXL	20.60	+0.62	373	+23
	90	80	68	B-	30.95	BurgerK	BKC	20.51	-1.35	4,775	+230		99	92	98	B+	33.84	HMS Hld	HMSY	34.12	+0.99	430	+18
	79	59	63	D+	63.77	CocaCFmsa	KOF	33.49	-1.10	540	+203		86	89	80	C	106.3	Itron Inc	ITRI	60.72	+0.53	842	+15
	72	59	55	D	34.53	Unilever	UN	21.10	-0.87	7,453	+162		99	85	95	C+	49.06	Allegiant	ALGT	34.38	+1.38	637	+15
	98	94	93	B	171.4	TerraNit	TNH	122.5	-4.55	228	+158		98	95	86	A-	36.95	Synaptics	SYNA	25.84	+0.59	1,804	+14
	98	78	96	B	32.50	FamilyDlr	FDO	26.63	-1.68	9,139	+126		96	91	98	D+	33.43	Thoratec	THOR	27.17	+0.63	1,775	+12
	55	77	35	E	86.91	Credicorp	BAP	37.61	-0.54	895	+123		84	75	97	C+	61.24	FuelSys	FSYS	27.04	+1.29	785	+10
	90	84	81	C+	65.54	ChrchDwt	CHD	52.50	-1.45	1,319	+113		91	98	61	D+	50.00	ConcurTch	CNOR	22.77	-2.46	8,955	+788
	98	93	77	B-	73.73	NovNrdk	NVO	52.73	-0.85	525	+102		94	84	90	B-	44.32	DollarTree	DLTR	35.03	-6.72	12,381	+476
	76	98	42	B-	83.81	ContlRes n	CLR	21.09	-0.90	2,779	+94		44	72	32	D	60.24	Varian	VARI	26.91	-2.04	1,091	+302
	76	91	61	D	68.09	RoperInd	ROP	39.50	-0.75	1,572	+88		99	89	89	C	47.94	QualtySys	OSII	35.23	-1.88	1,975	+299
	75	59	57	C+	34.89	Unilever Plc	UL	20.74	-0.58	2,042	+86		94	82	97	A	29.21	MultFnElc	MLFX	19.02	-1.00	646	+297
	19	42	8	D-	99.46	Orix	IX	21.27	-1.21	256	+82		88	72	72	B	44.10	PanAmSlvr	PAAS	16.60	-1.45	5,480	+255
	81	53	82	D	31.26	BrklyWR	WRB	24.55	-0.51	2,617	+70		80	76	57	C	42.58	Dentsup	XRAY	26.88	-0.57	5,920	+194
	98	98	71	B-	81.59	NwOriEd	EDU	52.00	-2.00	894	+65		81	82	62	B	80.60	Dionex	DNEX	49.52	-1.22	408	+180
	84	63	76	C+	92.13	Exelon	EXC	57.11	-0.57	6,002	+64		38	48	22	D	64.22	AdvsrBrd	ABCO	16.59	-1.07	303	+150
	95	89	93	B-	67.44	Sunoco	SUN	41.12	-3.79	6,913	+63		99	82	96	A-	39.29	Athenanit n	ATHN	35.38	-1.82	1,166	+134
	84	78	69	D-	50.00	AON	AOC	36.45	-0.96	5,307	+63												

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in price. This zeroes in on the daily supply and demand for leading securities. It was a bearish day.

I've found this computer screen to be valuable. For it to fail to pick up a new big leader is almost impossible. But you've got to do your own homework to understand some of these names you might not know. IBD also tries to cover these companies in our various columns.

How's The Market?

Page B2 is titled "How's The Market?" It is loaded with absolutely crucial data. We present the four key general market indexes—the NYSE composite, Nasdaq, S&P 500, and Dow Jones Industrials—in large, easy-to-read charts. We stack them one on top of the other so you can compare them and see which indexes are stronger and if one index diverges from the others at some point. At this time, we note that while all the indexes were in a negative trend in January, the Nasdaq was down only 2%, less than the others, implying it is the leader at this stage in a difficult market.

We also have relative strength lines, moving average lines, and a line just below the NYSE Composite chart that displays the New York Stock Exchange advance-decline line, which let's you quickly see day by day over the last six months if more stocks on the NYSE were advancing or declining. There's even an Accumulation/Distribution measure showing which of the major indexes has the largest amount of accumulation. At this reading, the Nasdaq had a "B-," meaning it has recently enjoyed stronger accumulation than the others.

B2 is a page I look at every day, and you should too. I want to carefully check the recent price and critical volume activity of the leading indexes on a day-by-day basis to see if they're still in an uptrend and under accumulation or if they're shifting into a new downtrend and behaving in a highly negative way. Don't neglect the daily volume; it's the key that can tell you if something is going wrong. If you study and learn to interpret the general market indexes correctly, which can take some time, you will learn how to avoid most of the serious declines *because the increased distribution always shows up in the early stages, before the more damaging part of a decline evolves*. This can preserve a good bit more of your money and is something it's definitely worth striving to perfect, no matter how much time it may take you. How much time, after all, did you spend earning the money you now hope to invest? So is it worth your time to learn how to skillfully preserve and protect it?

If you learn to read the market and apply IBD's general market rules, there's no excuse for finding that you are down 30%, 40%, or 50% or more in any bear market. I know most public investors and maybe some readers of the paper were possibly hurt in the market correction of 2008. But IBD supplied the rules and information. If readers did their homework and read the "The Big Picture" column, they should have seen that IBD's method picked up the adverse activity in the earlier stages of the emerging bear market decline that developed in late 2000 and 2008.

You Can and Must Learn to Spot the Following

October 3, 2007, was the first distribution day on the Nasdaq, October 11 was the second, October 15 and 16 were the third and fourth, and October 19 was the fifth. If you saw and read this correctly, you would have sold something. On October 24 you had a sixth distribution day, and you should have cut back further. By November 1, you had seven crucial warnings. This is how all important market corrections and bear markets begin. If you missed this and were totally unaware of what was happening, go back and study all the market-top charts in Chapter 9 until they make sense to you and you understand what you must look for in the future. Many investors

have discovered they need to take charge, get serious, and learn the basics of sound, successful investing. You can do far better in the future.

IBD Mutual Fund Index

There is another unique feature on page B2 you can't find in other daily publications—the "IBD Mutual Fund Index," where we pick two dozen leading growth funds and show their composite performance in a graphic display. I use this as a supplementary index because it is in a way a giant advance-decline line of some of the better funds with a combined 1,000 to 2,000 or more stocks owned among the 24 funds. When I've seen a classic, well-formed cup-with-handle pattern in this index, preceded by a strong prior uptrend to the pattern, the index and the market have almost always moved up.



IBD's 197 Industry Sub-Group Rankings

On this jam-packed page, we also have IBD's "197 Industry Sub-Group Rankings." This list shows a composite rating for each sub-group and each sub-group's change from the previous day, plus where the group ranked three and six weeks and seven months ago. The top 20 and bottom 20 sub-groups are circled because they represent the best- and worst-performing industries.

By now, you should know I am not going to own anything in the bottom 20 because we've proven over many years that these industries are going to be having a lot of trouble. On the other hand, we know that most of the leading areas of a positive market will show up in the top 20.

	Rank			Industry	Subgroup	% Chg Daily
	3	6	7			
This Wk	Wks Ago	Wks Ago	Wks Ago	Name	Comp. Since	% Chg
Wk Ago	Wk Ago	Wk Ago	Wk Ago		Rating	Jan 1
1	60	38	78	Metal Ores-Gld/Silvr	90	+4.1+1.7
2	2	8	83	Comm Svcs-Schools	95	+8.1+0.4
3	8	12	57	Medical-Genetics	..	+16.4+0.9
4	4	10	98	Comm Svcs-Scrt	90	-4.7+0.1
5	18	20	80	Medical-Ethical Drgs	89	+1.7+0.6
6	15	33	23	Telecom-Wirless Eqp	90	-2.2+1.7
7	3	2	134	Comptr Sftwr-Mdcl	94	-7.3-1.4
8	7	4	133	Utility-Water Supply	89	+0.3+0.6
9	12	14	43	Medical-Biomed/Bth	89	+5.2+1.3
10	28	54	112	Financepl Inv Fdbnd	..	+14.2+0.3
11	6	9	118	Insrnce-Prp/Cas/Titl	81	-9.7+1.1
12	1	1	197	Trnsprttn-Airline	67	-22.8+3.7
13	10	19	104	Retail/Whlsle-Food	84	-0.4+0.2
14	17	26	77	Utility-Electric Pwr	87	+0.3+0.7
15	16	21	45	Utility-Gas Dstribtn	88	+1.6+1.3
16	14	22	94	Retail/Whlsle-At/Prts	85	-4.0+2.7
17	72	89	101	Oil&Gas-Trnsprt/Pip	87	+16.4+1.0
18	35	106	145	Oil&Gas-Rfing/Mkt	90	+15.9-0.1
19	24	48	191	Medical-Hlth Mnt Org	92	+10.5+3.6
20	13	5	99	Comm Svcs-Cnsltng	90	-6.8+0.7

The reason we have 197 subgroups is that within every sector, there are segments that can perform quite differently. Medical genetics is our third-ranking group. Seven months ago it was fifty-seventh.

All told, we have 10 tables that measure industries from different points of view. Two small boxes on page B2 that I also check each day give you another perspective on which industries are leading. One shows the “Top 10 Fidelity Industry Funds Since Jan. 1.”

The second small box shows the groups with the highest percentage of stocks at new highs. With several different ways to look at market sectors, you can hardly miss the one or two sectors that turn out to be the real leaders in each new bull market.

Next to those boxes, there’s a list displaying indexes of 28 different market sectors and how each performed for the day.

IBD Industry Themes

On page B3, we have another way of keeping track of industries—a daily column called “IBD Industry Themes.” In every market, there are certain leading themes. Investors may be buying medical stocks, for example, or technology stocks. So what are the themes in the current market?

We also have a column on New York and Nasdaq stocks and one for the long-term investor. Another three columns (on page B5) include “The Base Reader,” which analyzes various chart patterns, “The Income Investor,” and “International Leaders,” covering the foreign markets. I don’t read all these

Groups Highest % Of Top 10 Fidelity Industry Stocks At New High Funds Since Jan. 1

Tobacco	11%	1. Wireless	+17%
Retail/Wholesale-Food	11%	2. Netwk&Infr	+11%
Finance-Mortgage&Rel Svc	9%	3. Telecommun	+10%
Computer Software-Medical	8%	4. Gold	+8%
Retail-Home Furnshings	7%	5. Electronics	+7%
Retail/Wholesale-Auto/Prts	6%	6. Natural Gas	+7%
Retail-Super/Mini Markets	5%	7. Energy Svcs	+6%
Internet-Network Sitts	5%	8. Commequip	+5%
Computer-Integrated Syst	5%	9. Computers	+4%
Retail-Clothing/Shoe	2%	10. Natural Res	+4%

Today's general market highlights:

Energy dominated Thursday's list of top-performing groups. Crude jumped \$3.47 to \$51.61 a barrel, continuing oil's recent rally. Production cuts and oil companies' reduced investments have pinched supply, countering lower global demand.

Market Indexes list sorted by % gain in last 3 months. (★ on left, top 4 indexes since Jan. 1 on right, top 4 indexes yesterday.)

Since Jan 1	3 Month % Change	Index	Value	Change	Yesterday's % Change
+ 8.30% ★	+21.51%	Gold Index	91.31	+ 3.97	+4.55% ★
+ 9.71% ★	+ 9.95%	High-Tech Index	323.42	+ 2.95	+0.92% ★
- 4.42% ★	- 1.23%	Amex Composite	1335.74	+ 8.01	+0.60% ★
- 5.93% ★	- 4.44%	Nasdaq OTC Comp	1483.48	- 7.74	-0.52%
- 9.44%	- 7.31%	IBD New America Index	161.96	- 2.13	-1.30%
-11.01%	- 7.68%	Value Line Index	1250.09	- 4.17	-0.33%
-11.00%	- 7.77%	New Issues Index	220.72	- 1.56	-0.70%
-11.14%	- 7.99%	S&P Midcap 400	478.33	- 2.82	-0.59%
-13.36%	- 9.32%	Senior Growth Index	369.71	- 3.19	-0.86%
-11.17%	- 9.87%	Dow Jones Utility	329.33	+ 2.77	+0.85% ★
-12.37%	-10.23%	Defensive Index	872.86	- 5.95	-0.68%
- 9.83%	-11.11%	Consumer Index	604.03	- 3.83	-0.63%
-11.29%	-11.19%	Medical/Healthcare	2870.64	-102.20	-3.44%
-13.20%	-11.44%	S&P 500	784.04	-10.31	-1.30%
-14.24%	-12.11%	N.Y.S.E. Composite	4937.22	-38.08	-0.77%
-17.26%	-13.76%	Russell 2000	413.26	- 4.37	-1.05%
-15.67%	-13.99%	Dow Jones Industrials	7400.80	-85.78	-1.15%
-19.19%	-15.30%	S&P 600	217.16	- 2.50	-1.14%
-19.16%	-15.90%	U.S. Defense Index	494.43	- 7.06	-1.41%
-25.44%	-22.01%	Dow Jones Trans	2637.77	+ 4.79	+0.18%
-26.77%	-24.14%	N.Y.S.E. Finance	2818.02	-116.34	-3.96%
-29.17%	-26.86%	Bank Index	279.23	-25.81	-8.46%
-33.63%	-30.90%	Insurance Index	220.22	- 9.74	-4.23%

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columns. But I do read the headlines, and if a quick glance tells me a column is talking about some situation I'm interested in, I'll read it.

2,500 Leading Stocks (NYSE + Nasdaq Research Tables)

A powerhouse element we've added recently is the way we organize and display our one-of-a-kind stock tables. We call them "Research Tables" because we have a boatload of data on each company. IBD follows up to 2,500 stocks, combining New York and Nasdaq stocks in one table, whereas some of our competitors carry only 1,000 stocks and have nothing close to the critical ratings and data we provide for each company.

Right off the bat, you'll see that our "2,500 Leading Stocks" tables starting on page B3 are organized in order of the strongest of 33 broad economic sectors. Almost everyone else's tables are organized alphabetically. For decades, Americans used the stock tables in their local newspaper or in one of our financial competitors just to look up where their stocks closed yesterday: "Was my General Motors up, or was it down?" While it's nice to be able to check how your stock did, these days you can get quotes anywhere on the Web. What *we're* doing is making the tables an advanced research lab to help you discover the next big leading stock you'll want to invest in. Here's what we're able to do with how *we* display the tables.

This particular issue confirms what we saw in other tables: that the "Medical" sector is number one. Then we show every one of the stocks in the medical field, listed alphabetically. Each has a composite rating, which goes from 0 to 99, with 99 being the very best. This is an overall rating that considers key individual ratings. (Of course, this current rating could decline if

our government succeeds in its attempt to rewrite all the rules and decide how it wants to run our entire medical system.)

If you spot a stock that looks interesting, we have given you the stock symbol, and you can go to Investors.com and check out the chart or other vital facts and figures, using a handy checklist to flesh out what you've uncovered in the tables.

As I scan the tables, I look for stocks that are boldfaced. Here, too, we boldface anything that's up one point or more or is making a new high in price. I'm mainly interested in keeping track of price movements so I don't miss anything that might turn out to be a huge new leader. The boldfaced stocks can be scanned very quickly, and if you're using charts, you may already be aware of the patterns of some of the ideas you notice in the tables. For example, if you go through a number of charts every week, looking for sound patterns with strong fundamentals, and you scan the boldfaced stocks in the tables daily, you'll see a bolded stock whose chart you were impressed with start to move up.

When I spot unusual activity by high-ranked stocks, I tend to write down the symbol at the top of the B1 page. When I get through scanning the tables, I may have eight or ten symbols that I'll check out because they look interesting based on their price activity and high ratings. You can go right to Investors.com or Daily Graphs Online and evaluate the chart to see if the stock is acting right or acting poorly.

So rather than using the tables just to find out how my stocks did yesterday, I'm using them to screen for potential ideas that might become super leaders at some point in the future. For any serious investor, this is almost a necessity if you are going to improve your performance.

"You Can Do It Too"

At the top of page B4, we have something called "You Can Do It Too." These are short quotes by investors who have written to tell us they've done well and what their main observations were. I realize there are a number of people who probably aren't so successful or who haven't done their homework, didn't follow rules, or didn't have any system. Many of these quotes, however, are inspiring.

It's interesting that more than 1,000 people have written to tell us that they've finally figured out how to put it all together to achieve outstanding results. I say "finally" because it takes some time and effort to get truly superior results. There are no free lunches in the stock market. But once you understand and apply yourself, you could in time become financially independent. Would that be a worthy goal for you to strive for and achieve?

"Stocks in the News"

A section that I also check every day is what I call the "mini-charts" in the "NYSE Stocks in the News" and "Nasdaq Stocks in the News" sections. We used to show 20 or more charts in this screen, but we've now limited it to 10 because we've refined and improved the sorting mechanism. And what we've learned is that, once you're in any future bull market, these two lists will materially outperform the S&P 500 and any new names on the charts will be well worth your checking.

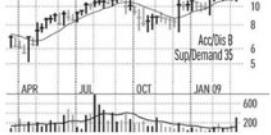
If you're in a bear market, don't expect these lists to work. Three out of every four stocks will be going down in such an environment, and growth situations can have significant corrections. But if you know you're in an uptrending market, and this is confirmed by the "The Big Picture" column, these mini-charts—each of which is packed with 20 key statistics—can be a source of high-probability new ideas. They won't all work. But when you're in a positive market, you follow up on the ideas that work. Sooner or later, if you're patient, a market will develop into a strong bull market. And when that happens, these are definitely screens you want to check out thoroughly. If you do your homework, you then have a better chance of materially improving your performance.

Over time, I've found that the first six or seven sectors in our stock tables will contain most of the new leaders. I've also found that just

NASDAQ STOCKS IN THE NEWS

AMERICA SERVICE GROUP (ASGR) Group 60 \$12.34
94 Comp. Rating 77 EPS RS 98 ROE 10% 8.5M Shares
PROVIDES MANAGED HEALTHCARE SERVICES TO OVER 120 CORRECTIONAL FACILITIES.

Ann. EPS Gro PE 28 Avg. Daily Vol 25,400 Debt 0%
Last Qtr Eps +175%▲ Prior Qtr +157%▲ Last Qtr Sales +5%
4 Qtrs EPS > 15%
Eps Due 4/30



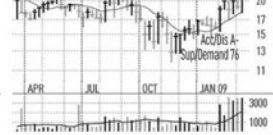
H M S HOLDINGS CORP (HMSV) Group 25 \$35.33
99 Comp. Rating 95 EPS RS 98 ROE 13% 22.1M Shares
PROVIDES COST CONTAINMENT, REVENUE RECOVERY, REIMBURSEMENTS AND BENEFITS COORDINATION TO GOVERNMENT HEALTHCARE PROGRAMS.

+37% Ann. EPS Gro PE 44 Avg. Daily Vol 409,200 Debt 6%
Last Qtr Eps +73%▲ Prior Qtr +44%▲ Last Qtr Sales +26%
3 Qtrs EPS > 15%
Eps Due 5/5



NEUTRAL TANDEM INC (TNDM) Group 46 \$20.96
98 Comp. Rating 99 EPS RS 97 ROE 9% 17.1M Shares
PROVIDES TANDEM SWITCHES USED BY TELECOM SERVICE PROVIDERS TO INTERCONNECT/EXCHANGE TRAFFIC BETWEEN NETWORKS

+157% Ann. EPS Gro PE 29 Avg. Daily Vol 425,500 Debt 2%
Last Qtr Eps +317%▲ Prior Qtr +217%▲ Last Qtr Sales +41%
5 Qtrs EPS > 15%
Eps Due 5/5



NETFLIX INC (NFLX) Group 23 \$39.37
99 Comp. Rating 94 EPS RS 98 ROE 23% 25.8M Shares
PROVIDES AN ONLINE MOVIE RENTAL SUBSCRIPTION SERVICE OFFERING MORE THAN 90,000 MOVIE AND TV TITLES VIA NETFLIX.COM

+50% Ann. EPS Gro PE 27 Avg. D. Vol 2,081,100 Debt 11%
Last Qtr Eps +38%▲ Prior Qtr +38%▲ Last Qtr Sales +19%
4 Qtrs EPS > 15%
Eps Due 4/21
R&D 0%



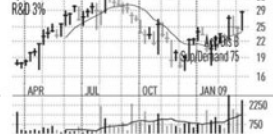
S X C HEALTH SOLUTIONS (SXCII) Group 6 \$20.29
97 Comp. Rating 94 EPS RS 98 ROE 0% 20.4M Shares
PROVIDES PHARMACY BENEFIT MANAGEMENT AND HEALTHCARE IT SERVICES TO THE NORTH AMERICAN PHARMACEUTICAL BENEFITS INDUSTRY.

+7% Ann. EPS Gro PE 23 Avg. Daily Vol 207,600 Debt 0%
Last Qtr Eps +56%▲ Prior Qtr +41%▲ Last Qtr Sales +1143%
3 Qtrs EPS > 15%
Eps Due 5/8
R&D 16%



CARDIONET INC (BEAT) Group 34 \$28.63
98 Comp. Rating 72 EPS RS 98 ROE 14% 19.5M Shares
DEVELOPS AN AMBULATORY, CONTINUOUS, REAL TIME MANAGEMENT SYSTEM AND SERVICE FOR MONITORING PATIENT CARDIAC DATA.

Ann. EPS Gro PE 77 Avg. Daily Vol 304,700 Debt 0%
Last Qtr Eps +70%▲ Prior Qtr +38%▲ Last Qtr Sales +44%
6 Qtrs EPS > 15%
Eps Due 4/29
R&D 3%



because some of the sectors in the back half haven't been leaders recently doesn't mean that some of them won't later possibly become turnarounds. Lower-ranked and poor-performing sectors in this issue are Computer—Hardware, Savings & Loans, Apparel, Machinery, Media, Steel, Real Estate, and Semiconductors.

These rankings can shift over a period of weeks or months. But it pays to know what's leading now and which names within each sector have the best fundamental and market-action variables. That's where you want to concentrate your research.

These tables may take a little time to get used to. But after a few weeks, you'll know where your stocks are listed. To make it easier, we also have a table that lists all of IBD's 197 subindustries and tells you which of the 33 broad sectors each subindustry belongs to.

One thing that most of us fail to do, but that I would highly encourage you to do, is read the box (usually on page B7) that explains the various ratings and measures and how they're computed and used. By doing this, you will understand how best to utilize these advanced, very sophisticated tables that could hold the key to dramatic success or improvement in your future.

Below the how-to-read box is a short list of "do's and don'ts"—in other words, what you should be doing to avoid the classic errors people sometimes make when they're investing without doing their due diligence.

IBD Timesaver Table

The "IBD Timesaver Table" on the same page is a feature many busy people like to use because it picks up all the high-ranking stocks that were up or down in price in a short table that includes volume and some other rankings. I always check this and take particular note of the "Stocks Down" list. I want to be aware of the stocks that have been hit hard because this could affect others in the same industry. If a stock shows up repeatedly on this list, it could be that it has topped and is headed for more trouble.

I've mentioned that we have 10 different ways you can zero in on the leading groups. We also have little sector charts under the heading "Leading Market Indexes." Each has a daily price and volume chart. Hi-tech, Junior Growth, Leisure, and Consumer Sectors now top the list.

Alongside, we have the "New Highs" list. This list has also been reorganized. We weren't interested in just showing which stocks made new highs and which made new lows. We list them in order of the industry sectors that had the largest number of stocks making new price highs. When you get into a strong bull market and find that, say, the medical sector continues to lead, it will probably be among the top one, two, or three sectors with the most stocks making new highs.

IBD TIMESAVER TABLE

Combined summary of key price action for NYSE & Nasdaq highest-rated stocks, a quick and easy snapshot for busy investors. Stocks up at least 1 point or making new highs, and stocks down 1 point or making new lows are boldfaced. Sorted by Composite Rating, IBD's single most useful fundamental and technical gauge.

SMARTSELECT® COMPOSITE RATING											
EARNINGS PER SHARE											
RELATIVE PRICE STRENGTH											
INDUSTRY GROUP RELATIVE STRENGTH											
SALES+PROFIT MARGINS+ROE											
ACCUMULATION/DISTRIBUTION											
52-wk High	Stock Symbol	Close Price	Chg	Vol 1000	P E	52-wk High	Stock Symbol	Close Price	Chg	Vol 1000	P E
STOCKS UP											
99	99 86 A	A-B-	40.3	EBIX	24.67	+3.86	+273	309	10		
99	97 94 A	A-C	27.2	Netease	NTES	22.23	+1.14	+180	32m	13a	
99	97 85 A	A-C	57.6	GileadSci	GILD	45.43	+1.00	-6.87m	20a		
99	96 98 A	A-A	NH	ScherPly	SGP	24.21	+1.89	+142	49m	13a	
99	95 98 A	A-B	NH	HMSHld	HMSY	35.33	+1.45	+77	725	44a	
99	92 84 A	A-D	81.4	Cephalon	CEPH	66.32	+1.92	-5.18m	13a		
99	77 99 A	A-B	33.5	AmitPstn	AIPC	32.09	+1.37	-1.427	14a		
99	99 97 A	A-A	NH	NeuTandn	TNDM	20.96	+0.05	+151	1.1m	28	
99	99 86 A	A-B	382	Baidu	BIDU	172.7	+3.26	-32.17m	36a		
99	99 75 A	A-D	77.4	Celgene	CELG	48.20	+1.04	+14.69m	30a		
99	94 95 B	A-C	18.7	Beacon	BECN	12.65	+1.27	+169	1.7m	10a	
99	93 83 A	B-D	52.0	MedcoHlth	MHS	40.98	+2.26	+4.45m	17a		
99	92 98 A	A-B	38.2	ShandaInt	SNDA	36.31	+1.21	+23.18m	13a		
99	88 97 A	A-B	67.0	EdwLdSci	EDW	61.40	+2.33	+23.759	23a		
99	88 97 A	A-B	31.0	CmptPr	CPSI	27.75	+1.54	+71	328	19	
99	87 91 A	A-B	48.7	Teva	TEVA	45.39	+1.09	+18.81m	16a		
99	87 87 A	A-C	62.4	GenProbe	GPRO	44.86	+1.21	-29.515	23a		
99	72 98 A	A-B	35.9	CardioMetn	BEAT	28.63	+1.55	+197	905	77a	
99	45 98 A	B-B	NH	Pegsys	PEGA	17.23	+0.06	+197	566	57	
99	89 95 A	B-D	39.1	EmergEdvs	EMS	31.35	+1.70	-13.174	15		

SMARTSELECT® COMPOSITE RATING											
EARNINGS PER SHARE											
RELATIVE PRICE STRENGTH											
INDUSTRY GROUP RELATIVE STRENGTH											
SALES+PROFIT MARGINS+ROE											
ACCUMULATION/DISTRIBUTION											
52-wk High	Stock Symbol	Close Price	Chg	Vol 1000	P E	52-wk High	Stock Symbol	Close Price	Chg	Vol 1000	P E
STOCKS DOWN											
97	99 80 B	B-B	58.0	Powell Inds	POWL	32.53	-2.60	+12.102	12		
97	94 63 B	A-A	42.6	NasdaqQMX	NDAQ	22.27	-1.66	+12.44m	11a		
96	99 76 B	A-B	89.8	Visan	V	52.05	-2.04	+35.12m	21a		
95	96 79 C	A-B	87.9	CmpSMin	CMP	53.43	-8.24	+100	23m	10a	
94	95 76 B	A-C	145	Mnsnto	MON	79.11	-2.58	+3.98m	18a		
93	90 79 B	A-C	66.2	Stericycle	SROL	48.42	-2.16	+55	18m	27a	
92	88 74 B	B-B	66.8	Syngenta	SYT	37.52	-3.47	+233	26m	11a	
86	92 70 B	B-C	66.9	PrePrfmln	PLPC	39.00	-3.00	+225	18	12	
84	82 47 B	A-B	526	CMEGr	CME	198.2	-2.80	+7.16m	11a		
84	67 69 B	B-B	69.2	PHILLD	PHI	42.61	-5.14	+88	339	10a	
82	78 71 C	A-B	100	OcciPet	OXY	54.69	-1.77	-4.88m	6a		
75	94 39 B	A-D	67.7	AlliancDta	AOS	30.78	-1.72	0.23m	6a		
75	30 83 A	B-C	355	FairHxFl	FFH	241.0	-5.51	-27.48	3a		
73	77 40 C	A-C	95.2	Contango	MCF	36.64	-1.66	-31.105	5a		
65	40 66 B	B-D	168	ArtGpA	ARONA	91.69	-3.27	-73.03	11a		
63	80 52 C	B-C	713	WashPost	WPO	344.3	-10.61	+4.42	10		
63	69 60 B	D-C	17022	BrkHsA	BRKA	8350	-750	-23	1	13	
62	45 51 A	B-C	249	Blackrock	BLK	108.0	-3.20	-17.710	16a		
57	69 59 B	D-D	400	BerkHsB	BRKB	2742	-39.00	-20	37	13	
55	39 66 B	B-E	105	Seaboard	SEB	933.0	-6.00	-36.07	7		

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When high technology was leading in the bull market of the 1990s, the computer sector was number one for a year and a half. Stocks like Cisco and Dell were constantly on the new-high list. If you knew what you were looking for, and you understood the significance of a stock's displaying new highs in a bull market, maybe you too could have participated when these stocks were going up 10 times or more. There's a lot you can learn by studying past markets. We are historians.

In other words, it's hard *not* to notice the real action and the real leaders in the market. They are as obvious as the elephant that jumps into the bathtub and splatters water all over the place. When a whole sector is moving, the sheer volume and broad-based activity cannot be ignored. We saw this in the energy sector from 2004 to 2007, when virtually all oil and gas stocks were moving up dramatically.

At some point, all sectors change. And when they do, the 10 different ways we have to pick up leaders and laggards will point you in a direction where you can say, "Those stocks are no longer leading the way they did before." If you just go on emotions and your attachment to a stock, you can get into a lot of trouble. You need precise measurements to tell you if this sector or that security is really behaving properly.

Company Earnings Reports

IBD's earnings reports feature stock symbols, industry groups, percent above or below consensus estimates, and EPS and Relative Strength Ratings. Earnings growth greater than 25%, a key characteristic of winning stocks, is boldfaced. The whole line is boldfaced when EPS growth is more than 25%, EPS Rating more than 85, and earnings are stronger than expected. Arrows indicate acceleration or deceleration in earnings or sales growth compared with the prior quarter. Data reported may be derived from 6-, 9- or 12-month reports. All earnings represent the current quarter. Foreign companies are not reported. Nonrecurring items may be excluded from earnings per share. Unique circumstances are taken into account for many industry groups. Sales may not apply for certain industries. Real estate investment trusts may reflect EPS or funds from operations.

Company Name	Symbol	Industry	Closing Price	Curr Qtr Ems	Prior Yr's Qtr Ems	EPS %Chg	Under /Over Est %	Sales % Chg	Sales % Chg	EPS Str	Rel Str
94 Ups											
Hill-rom Holdings	HRC	Medical-Systems/Eqp	12.71	0.25 vs	0.22	+13.6↓	+25	352	+3.0↓	63	15
Horace Mann Educ	HMN	Insrnce-Prp/Cas/Titl	9.92	0.51 vs	0.49	+4.1↓	+16	221	-0.2	86	70
I Two Technologies	ITWO	Comptr Sftwr-Entr	7.48	0.31 vs	0.26	+19.2↓	+41	63.8	+0.8	64	43
IMS Health	RX	Comm Svcs-Hlthcare	15.49	0.50 vs	0.43	+16.3↓	0.0	581	-4.1	81	71
Infinity Ppty&Csity	IPCC	Insrnce-Prp/Cas/Titl	39.44	1.78 vs	1.16	+53.5↑	+109	200	-25	73	86
Isilon Systems Inc	ISLN	Elec-Smicondctr Mfg	2.89	-0.04 vs	-0.11	..	..	31.8	+19↓	38	40
Kellogg	K	Food-Misc Preparation	43.68	0.47 vs	0.44	+6.8↓	-6.0	2933	+5.0↓	76	73
Knoll Inc	KNL	Hshldoffic Furnitr	7.37	0.52 vs	0.42	+23.8↓	+27	276	-2.0	92	25
Luminex	LMNX	Medical-Systems/Eqp	21.97	0.05 vs	-0.08	+163↓	-17	28.2	+31↓	67	97
Mastercard Inc Cl A	MA	Financial Svcs-Misc	159.8	1.87 vs	0.89	+110↑	+15	1225	+14↓	99	71
Maximus	MMS	Comm Svcs-Consultg	37.89	0.67 vs	0.56	+19.6↑	+1.5	180	+17↓	56	95
Mednax Inc	MD	Medcal-Outpt/Hm Cr	37.26	0.85 vs	0.80	+6.3↑	+9.0	298	+19↑	73	68
Merrit Medical Syst	MMSI	Medical-Products	16.77	0.20 vs	0.17	+17.6↓	0.0	58.0	+6.7↓	78	88
Metavante Tech	MV	Financial Svcs-Misc	16.48	0.36 vs	0.28	+28.6	-2.7	433	+6.2↑	79	68
Micros Systems Inc	MCRS	Comptr-Intgrtd Syst	15.09	0.37 vs	0.34	+8.8↓	+5.7	238	-2.5	88	38
Microtune Inc	TUNE	Elec-Smicondctr Mfg	1.79	0.04 vs	0.03	+33.3	+100	24.0	+5.5↓	39	27
Micrus Endovascucl	MEND	Medical-Products	9.61	-0.07 vs	-0.28	..	..	18.3	-0.1	53	56
Multi Finline Elec	MFLX	Elec-Cmpnent/Cntr	19.02	0.56 vs	0.54	+3.7↓	+9.8	217	+18↓	82	97
N C R	NCR	Comptr-Intgrtd Syst	10.44	0.58 vs	0.54	+7.4↓	+7.4	1421	-6.6	82	19
National Bkshrs VA	NKSH	Banks-Southeast	18.15	0.52 vs	0.46	+13.0	+4.0	14.9	-1.1	72	86
Neutral Tandem Inc	TNDM	Telecom-Services	17.74	0.25 vs	0.06	+317↑	+32	34.9	+41↑	99	86
Newbridge Bancorp	NBBC	Banks-Southeast	2.18	-0.53 vs	-0.67	..	..	32.0	-16	13	11
Nutrition 21	NXXI	Cosmetics/Persnl Cre	.19	0.01 vs	-0.06	+117	..	12.9	-1.1	31	28

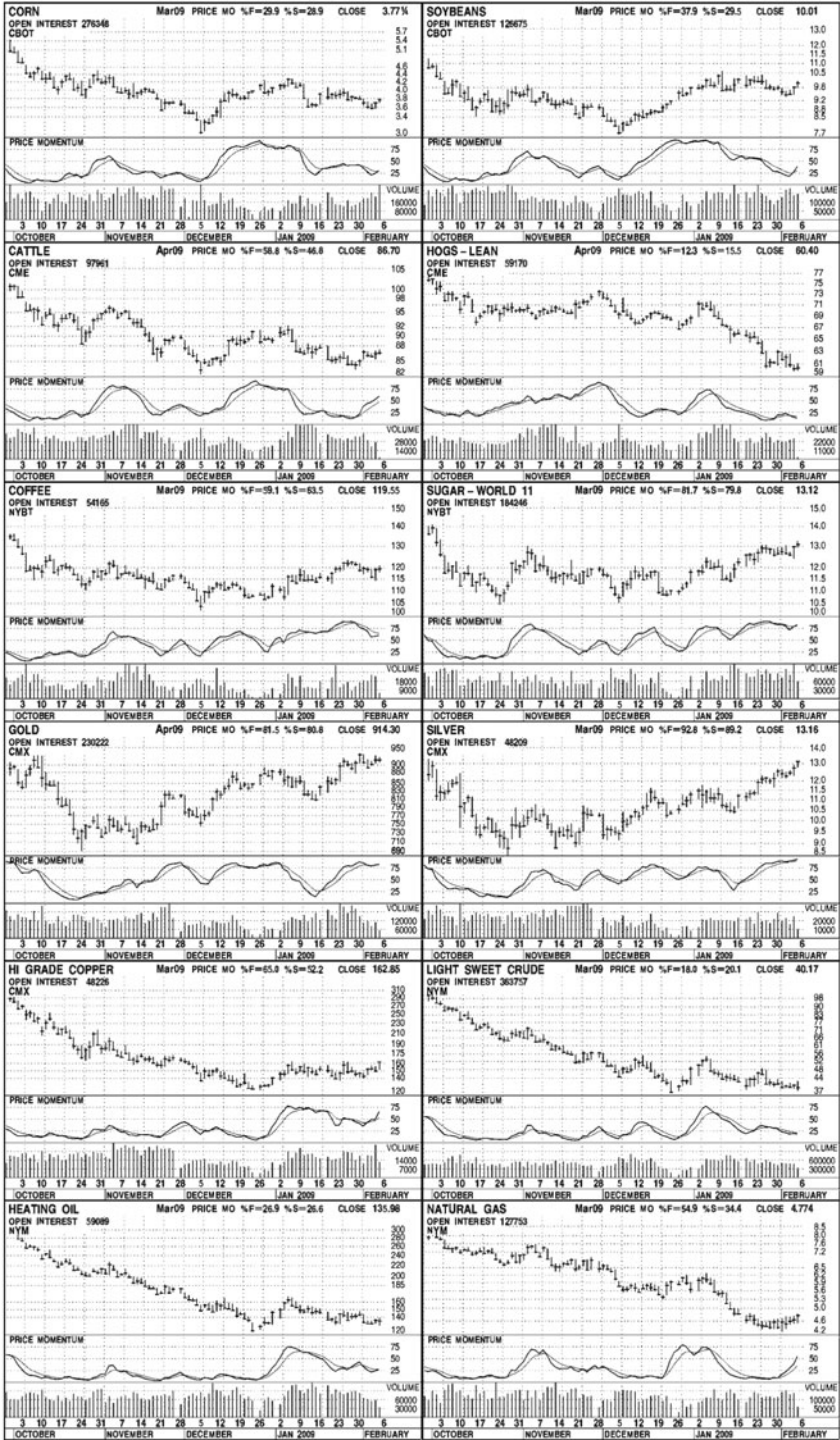
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One last thing: earnings are what drive a stock, and the rate of earnings improvement is more important than the P/E ratio. So, you want to make sure you check the "Company Earnings Reports" that come out at certain times during a quarter. You can discover a company that's suddenly showing much better earnings than in the past.

It helps to be up on stocks that come through with better-than-expected earnings—that the Street refers to as "earnings surprises." What we have learned to watch for are stocks whose earnings estimates are constantly being raised and that show an acceleration in their percentage rate of increase in earnings quarter by quarter. As mentioned earlier, the bigger the earnings increase, the better. And we don't fall into the trap of eliminating any stock just because its P/E ratio looks high.

To wrap up the paper, we cover more futures and options than most publications. There's a column on the bond market, several interest-rate charts and tables, and no fewer than 36 charts on commodities futures.

Key Commodity Futures



Money Rates

Prime Rate: 3.25
Base interest rate charged by major U.S. commercial banks on loans to corporations.

Discount Rate:
Primary 0.50
Secondary 1.00
Rate charged by Federal Reserve System on loans to depository institutions

Broker Call Loan Rate: 2.00
Rate charged on short-term loans to brokerage dealers backed by securities.

Federal Funds Target Rate: 0.00-0.25
Rates on overnight loans among financial institutions.

Certificates of Deposit:
1 month 0.87
3 months 1.37
6 months 1.82
1 year 2.27
Interest rate paid by dealers for certificates of deposit based on the duration of the security.

Jumbo CDs:
1 month 0.87
3 months 1.46
6 months 1.94
1 year 2.39

London Interbank Offered Rate:
3 months 1.24
6 months 1.77
1 year 2.09
The average of rates paid on dollar deposits.

Treasury Bill Auction Results:
3-months (as of Feb. 2) 0.270
6-months (as of Feb. 2) 0.390
Average discount rate for Treasury bills in minimum units on \$10,000.

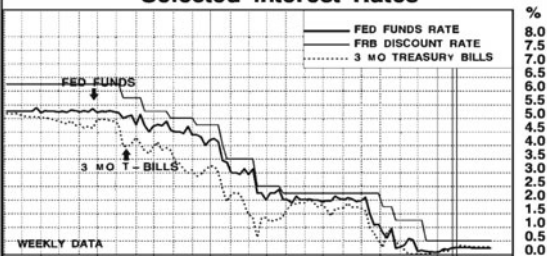
Treasury Bill:
1-year, (as of Feb. 2) 0.49
Annualized rate on weekly average basis, yield adjusted for constant maturity.

For Friday, February 6, 2009

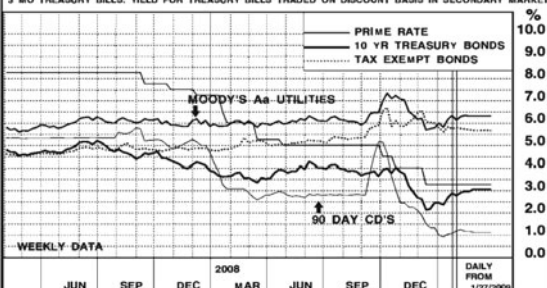
Bonds Summary

	Domestic		All Issues	
	Fri	Thu	Fri	Thu
Issues traded	2	1	2	1
Advances	2	1	2	1
Declines	0	0	0	0
Unchanged	0	0	0	0

Selected Interest Rates

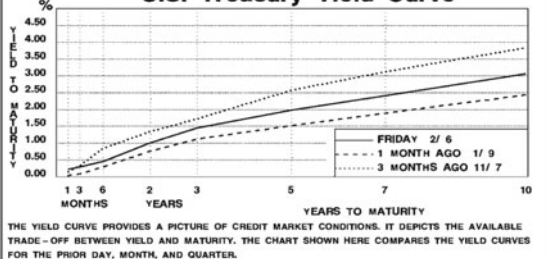


FED FUNDS RATE: RATES ON OVERNIGHT LOANS AMONG FINANCIAL INSTITUTIONS
DISCOUNT RATE: RATE CHARGED BY FEDERAL RESERVE BANK ON LOANS TO COMMERCIAL BANKS
3 MO TREASURY BILLS: YIELD FOR TREASURY BILLS TRADED ON DISCOUNT BASIS IN SECONDARY MARKET



PRIME RATE: RATE CHARGED BY BANKS ON LOANS TO THE MOST CREDIT-WORTHY CORPORATIONS
TAX-EXEMPT BONDS: YIELD OF THE BOND BUYER 40 MUNICIPAL BOND INDEX
90 DAY CD'S: RATES PAID BY MAJOR BANKS ON NEW CERTIFICATES IN BLOCKS OF \$1 MILLION OR MORE
MOODY'S Aa UTILITIES DATA ARE TWO DAYS PRIOR

U.S. Treasury Yield Curve



"Investor's Corner" and IBD 100

Among other IBD features, "Investor's Corner" is a popular daily educational column for anyone who wants to learn more about investing. And every Monday we show the IBD 100, with charts on 100 high-ranked potential prospects.

How to Use the Award-winning New Investors.com

Investors.com is the online companion to *Investor's Business Daily's* print edition. Like the newspaper, it helps you quickly and confidently apply the investing strategy outlined in this book. Whether you have just a few min-

utes each day or you're investing full-time, you can develop an effective routine that fits your schedule using the tools and features found on Investors.com.

We discussed the ways *Investor's Business Daily* starts the research process with an efficient assessment of the market, industry groups, and stocks. Here are some additional ways to dig deeper in your research with IBD's specially designed screening tools and charts.

If you're reading this book to hone your investing skills, going through these tools in the following manner will help you develop an easy daily system for reviewing the market, top industries, and, finally, the top stocks.

The IBD Stock Research Tool on the home page of Investors.com is structured to let you do just that from one central location. As you can see from the graphic on this tool, you can use it to follow "Market Direction" and to "Find," "Evaluate," and "Track" leading stocks. Following this approach will help you find the best stocks, will let you know the right time to buy and sell, and could materially improve your results.

The key is to take some time to become familiar with the investing tools and features on Investors.com. The CAN SLIM chapters in this book will help you understand the rationale for IBD's investing tools, which are programmed to search for companies with the performance characteristics typical of emerging stock market winners.

Market Direction

As discussed, three out of four stocks usually follow the overall market trend, whether it's up or down. That's why it's critical for you to learn to follow, not fight, the market. Within the "Market Direction" tab, you'll find links to features that will help you do just that.

Start by taking another look at the "The Big Picture" and "Market Pulse" to see what stage the market is currently in. You can also click on the "Indexes" link to view the latest charts for each of the major indexes. The charts are updated throughout the trading day with a 20-minute delay.

For timely analysis of the market action as it happens, read the "Markets Update," featuring intraday reports. You'll find concise insights that put the day's events into perspective, plus highlights of leading stocks making a big move.

IBD TV: "Market Wrap" Regularly watching the IBD "Market Wrap" video is a good way to stay on top of the market and improve your analytical skills. Available hours after the close each trading day, this short video uses charts to visually show you how the market and leading stocks are acting, and what trends and potential buy points to look out for.

Market Direction

Intraday Updates
The Big Picture
Market Pulse
Indexes

Find Stocks

Stocks on the Move™
Screen Center
IBD's Real Most
Active

Evaluate Stocks

Stock Checkup
IBD charts
Daily Stock Analysis

Track Stocks

My Stock Lists

IBD Stock Research Tool

MARKET DIRECTION

FIND STOCKS

EVALUATE STOCKS

TRACK STOCKS

Stocks on the Move ▾



Stocks being BOUGHT heavily by institutional investors.
Click icons for analysis. [Learn More](#)

Symbol	Company	Price	Price Chg.	Price % Chg.	Volume % Chg.	IBD Tools
FIRE	Sourcefire Inc	22.31	2.19 ↑	9.82% ↑	439%	
AMSC	American Superconductor	35.34	6.50 ↑	18.39% ↑	316%	
ASIA	Asianinfo Holdings Inc	23.29	3.43 ↑	14.73% ↑	299%	
NUS	Nu Skin Enterprise	23.68	0.61 ↑	2.58% ↑	211%	

[View All »](#)

Last Update: 10/29/2009

Find Stocks

Once you've reviewed the current market conditions, use the "Find Stocks" tab to look for new investing ideas. Here you'll find a wide range of idea-generating screens in addition to those in the IBD print edition.

"Stocks on the Move™"—Learn What the Institutions May Be Buying and Selling as It Happens This is the online version of the IBD print edition feature. As we've mentioned earlier, just looking at typical most-active lists won't give you the whole picture. You need to know about the emerging institutional trades that are beginning to show promise.

These stocks will appear on this radar screen, which is updated continuously throughout the trading day. You can quickly spot the stocks that institutions may be moving into—or out of—in a major way as it happens. Remember that institutional buyers who are taking a position in a stock usually buy in huge quantities, which may create major volume in the stock.

Nearly every winning stock will show this type of activity at the onset of its price advance. You don't want to miss this screen if you are searching for emerging leaders. Remember that not all the stocks shown on this list will be winners. It's important to check further to make sure the stock's chart looks sound and the ratings show leadership potential. This is a good way to spot the breakout of a stock as it is happening or shortly thereafter.

Intraday Volume Percent Change—Another Way to Spot Possible Winners A key element of the online version of "Stocks on the Move" is the *intraday* volume percent change. As we've seen, a stock needs support from institutional buying to propel it further. Volume percentage changes on an intraday basis will tell you—as it is happening—if a stock is trading above or below its average daily volume of the last 50 trading days. That's a sign of institutional buying (or selling) and a key component of "Stocks on the Move." You can also get the intraday volume percent change for any stock you're looking at on the "Stock Quotes" page of Investors.com.

"Screen Center" Click on the "Screen Center" link to pull up the latest "Screen of the Day." Each day, there's a different list that sorts the entire stock database looking for potentially superior stocks based on important performance criteria.

To access additional stock lists, click on "Screen Center" in the drop-down menu within the "Stock Research" tab on the Investors.com home page. You'll find more possible ideas from lists including "CAN SLIM Select," "IBD 100," "Sector Leaders," "Tech Leaders," and "Long-Term Investor." This is a quick way to find leaders and the better possible ideas in different

categories. You can then check weekly or daily charts on these potential ideas plus earnings and sales data to pick the best ones to add to your watch list.

Most Active—NYSE and Nasdaq This daily column (also found in the print edition) highlights breakouts and basing patterns in the best institutional-quality stocks experiencing unusually heavy trading volume. You'll also find a discussion of potential buy points that indicate the best time to make initial and secondary purchases. This column will also flag potentially negative action as stocks reach their peaks.

Evaluate Stocks

Next, let's look at how you can evaluate any stocks you already own or are thinking of buying. There are many questions that should first be answered:

- Is this the right stock to own? Or are there better ones in its group?
- Is the stock in a leading industry group or a laggard one?
- If you own the stock, have you held it too long?
- If the stock looks fundamentally strong and you want to invest in it, is it too soon or too late?
- Are we in a bull market or a bear market?

These are just a few questions that need to be answered before you make your move. Two IBD investing tools—"IBD Stock Checkup[®]" and "IBD Charts"—will help you sort through the stock-picking puzzle.

"IBD Stock Checkup[®]" "IBD Stock Checkup" evaluates and compares more than 6,000 publicly traded companies and assigns a composite rating and a pass, neutral, or fail grade to put your ideas in the proper perspective. It's essentially a statistical summary report made up of several components, including

- Composite Rating
- Performance Within Group
- Group Leaders
- IBD Stock Checklist—with a pass, neutral, or fail grade

● **Red Light, Green Light**

For the composite rating and most of the components listed in "IBD Stock Checkup," you'll see a green (pass), yellow (neutral), or red (fail) icon. This is a quick and easy way to see if your stock passes muster in that particular category based on time-tested CAN SLIM criteria.

IBD Stock Checkup for CRM:



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About CRM: PROVIDES ON-DEMAND CUSTOMER RELATIONSHIP MANAGEMENT SOFTWARE APPLICATIONS AND SERVICES TO BUSINESSES WORLDWIDE.

☒ General Market ☒ Fundamental Checklist ☒ Technical Checklist ☒ View Chart

Rate A Stock:

How does a stock compare to others in its industry group?

PERFORMANCE WITHIN GROUP (CRM)

SALESFORCE.COM INC RANK WITHIN THE COMPUTER SFTWR-ENTERPRISE GROUP (101 STOCKS)

Composite Rating(98) Rank within Group: 5th

96%

EPS Rating(81) Rank within Group: 36th

65%

Relative Strength Rating(87) Rank within Group: 18th

83%

SMR Rating(B) Rank within Group: 40th

61%

AccDist. Rating(B) Rank within Group: 37th

64%

Composite - Group Leaders

1 ASIA

ASIAINFO HOLDINGS INC

2 CTFO

CHINA TRANSINFO TECH

3 EONC

EON COMMUNICATIONS CORP

4 LIMS

STARLIMS TECHNOLOGIES

5 CRM

SALESFORCE

☒ IBD® Stock Checklist

Composite Rating

98



GENERAL MARKET AND INDUSTRY GROUP (CRM)

General Market

Market in confirmed uptrend



Industry Group

Industry Group Rank

33



FUNDAMENTAL PERFORMANCE (CRM)

Current Earnings

EPS Due Date 02/25/2010

EPS Rating

81



Last Quarter EPS % Change

100%



Last 3 Qtrs Avg EPS Growth

100%



Qtrs of EPS Acceleration

0



Next Quarter EPS Estimate % Change

36%



Estimate Revisions

+



Last Quarter % Earnings Surprise

0.0%



Green, yellow & red signals let you know whether to go, pause or stop

Composite Rating As we discussed earlier, the composite rating is a quick way to know whether you should move ahead or not. With the color-coded icons within the “IBD Stock Checklist” (see page 375), it’s like a traffic light that tells you whether to go (green), slow down (yellow), or stop (red) in your research, and it will guide you toward only the very best companies.

Performance Within Group—Buy the Best Stocks in the Top Groups In the “Performance Within Group” section, you can see how the stock specifically performs against the rest of the stocks in its industry group. The rankings are based on IBD *SmartSelect* ratings. This will help you determine if you’re making the right choices. It’s easy to be swayed by news or TV tips, but this should give you a major edge by forcing you to stick to the facts.

Group Leaders—Pointing You Toward Real Potential Leadership No matter what you’ve bought or are thinking about buying, this screen shows you where the real leadership is. These are the stocks exhibiting the type of performance that might propel them further in an uptrending general market. You can click on each of the *SmartSelect* ratings to see which stocks in the group rank highest for that individual rating.

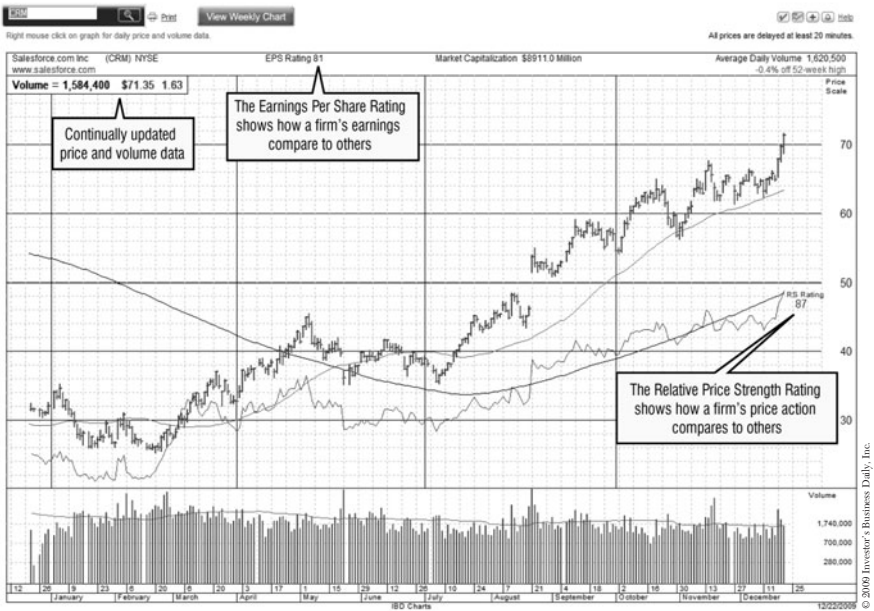
“IBD Stock Checklist” Is Your Stock Pass, Neutral, or Fail? The “IBD Stock Checklist” gives you a thorough review of the fundamental and technical strength of each stock, along with a pass, neutral, or fail grade for each category. For example, at the very top of the stock checklist, you’ll see a green, yellow, or red icon next to the composite rating. This will help steer you toward the true market leaders—and away from the laggards.

In the “General Market and Industry Group” section, you’ll also get a pass, neutral, or fail grade for the general market and for the relevant industry group. Do not buy stocks when the general market flashes a red signal.

IBD Charts Show You the Right Time to Buy or Sell You never want to buy any highly rated stock in IBD’s tables without first checking a chart, and it pays to regularly review both daily and weekly charts on any stocks you own. This is a vital step that will help you spot emerging trends and track a stock’s movement so you know the exact time to buy or sell. IBD charts are designed to make it easier and faster for both new and experienced chart readers to get the real picture. You can obtain these daily and weekly charts that are free on Investors.com.

For those who are intimidated by charts, think of a stock chart as a “picture worth a thousand words.” It will tell you some vital things about the progress (or lack of progress) of any company. In time, you will find your

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powered by INVESTOR'S BUSINESS DAILY™



review is quite automatic. Daily charts can also help you spot possible future winners. IBD daily charts include the following:

- Up days in price in blue; down days in red
- Continually updated price and volume data
- EPS and RS ratings
- Relative Price Strength line
- 50- and 200-day moving averages of price

Refer again to Chapter 2 to learn to recognize chart patterns. You may also want to consult the “IBD University” section of Investors.com for a course on chart analysis. Also remember that the majority of stocks tend to follow the overall trend of the market, so be sure to check current market conditions, as discussed earlier, to confirm that your overall timing is correct.

Weekly Charts—Tip-Off to Institutional Trading IBD weekly charts will help you gauge institutional buying. Since mutual funds typically take days, if not weeks

(and sometimes longer), to build (or unload) their positions, any heavy volume on the chart may tell you if they're possibly moving into or out of a stock in a major way.

Weekly charts include the same information that appears on the daily charts, with the addition of shares outstanding. These charts span nearly two years of price and volume movements.

To capture the biggest gains, it's important that you use both daily and weekly charts, since they offer different views on a stock. You will get more exact timing indications from the dailies and the big picture from the weeklies.

Track Stocks

Once you've evaluated and purchased a stock, it's crucial that you track its performance. "Buy and hold" is a dangerous strategy, as *all* stocks—even those of well-known, established companies—can be volatile and risky. To be a successful investor over the long haul, you need to keep all your losses small and to know when to sell and take your profits. Chapters 10 and 11 discuss how you can do that with time-tested sell rules. The "My Stock Lists" feature on Investors.com will help you stay organized so you can apply them effectively.

"My Stock Lists" With "My Stock Lists," you can create up to five lists with up to 50 stocks on each list. To stay organized and save time, you can



create different lists for different purposes. For example, you could create a “My Portfolio” list for the stocks you own, a list of “Stocks in Bases” for leading stocks that are currently forming a base, and a “Near a Buy Point” list for stocks that are approaching a proper buy point. It’s important that you review and manage your lists regularly, adding and deleting stocks as needed.

To help you track the performance of your stocks, the “My Biggest Price Movers” feature automatically alerts you to the stocks on your lists that are making the biggest price moves, up or down.

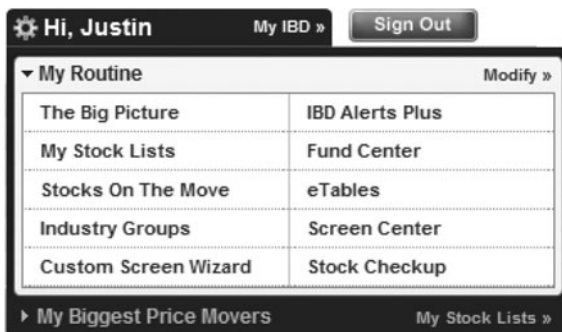
“My Stock Lists” also gives you one-click access to “IBD Stock Checkup,” IBD charts, and IBD archives for each stock. Use IBD archives to read what IBD has written about the companies you’re watching; it can provide valuable insight into the story behind the stock. Use “IBD Stock Checkup” and IBD charts to continually evaluate both the stocks you own and those you’re watching.

● “My Routine”: Create Your Own Custom Investing Routine

“My Routine” gives you one-click access to your favorite tools and features from virtually any page on Investors.com. It’s a convenient, time-saving way to go through your investing “to do” list quickly.

Here’s a sample routine you could set up to follow market direction and find, evaluate, and track your stocks.

1. “The Big Picture”
2. “Screen Center”
3. “Stock Checkup”
4. IBD Charts
5. “My Stock Lists”



eIBD—The Online Version of the Newspaper

We just talked about the unique elements of *Investor's Business Daily*. The paperless online version, *eIBD*, allows you to get that same information in IBD—and more—just hours after the market. So that advantage gives you a critical head-start on tomorrow's market. Here's how it works:

Say you're reading an article on the latest Apple innovation. Just put your cursor over the AAPL ticker symbol in the article, and instantly you get a window showing Apple's mini chart, a stock quote, and IBD's Stock Checkup Rating—all in one place. So it's a chance to size up a stock very quickly.

From there, you have one-click access to the research on Investors.com if you want to look further into a stock.

And the Intelligent Search feature helps to find any articles or data on stocks you're following—so if you type AAPL, it'll direct you to all the places we talk about Apple.

Equally handy is that this electronic version of the paper can be saved to your desktop or mobile device, printed, translated to another language or listened to via audio. The choice is up to you.

Continuing Education—The Key to Investing Success

"IBD University" For most investors, not a day goes by without questions. The "IBD University" section of Investors.com provides a complete stock investment course to help you improve your knowledge and skill. It outlines every aspect of buying and selling stocks, along with chart reading and many other important topics. The lessons are free, and you can take them at your own pace anywhere you have an Internet connection.

IBD TV: Daily Stock Analysis The "Daily Stock Analysis" video reviews the technical and fundamental strength of a current leading stock. Watching this every day will give you new investing ideas—and help you improve your own chart-reading and analytical skills. You can also read the "Daily Stock Analysis" column for a summary of key points discussed in the video.

"Investor's Corner"—Find Answers to Your Questions You can search the archives of the "Investor's Corner" column to quickly find detailed answers to beginning, intermediate, and advanced questions on a wide range of investing topics.

"IBDextra!" Monthly Newsletter The "IBDextra!" newsletter provides exclusive videos, articles, and stock lists to help you follow current market conditions, improve your investing skills, and get the most out of IBD's features and tools. The newsletter is free when you register on Investors.com.

● IBD TV: Watch Your Results Improve

IBD TV offers a unique way to reinforce and master the strategies outlined in this book.

The *IBD Market Wrap* and *Daily Stock Analysis* videos show you, on a daily basis, how to apply CAN SLIM in the current market conditions. We also produce special video and audio analysis as needed to help you navigate major market events, such as the financial crisis in 2008.

The key is to tune in regularly. Make IBD TV a part of your routine and you'll see your investing skills and confidence improve significantly. For the latest videos, visit www.investors.com/IBDtv.

Tap into the IBD Community

Since we started publication in 1984, IBD has helped countless people achieve financial success. It has created a vibrant community of investors who proactively share their ideas and knowledge, both online and offline. Here are two ways you can get involved in and benefit from the IBD community.

IBD Meetups

Each month, like-minded investors meet to share stock ideas and benefit from members' knowledge and experiences. Through discussing your individual investing strengths and trading mistakes, IBD Meetup gives you an opportunity to hone your CAN SLIM investing skills with the support of others, and ultimately, learn how to make more money. IBD's Meetup program is the largest investing Meetup organization in the world.

Look for officially sponsored IBD Meetup groups in your city by visiting www.investors.com/Meetup. No other newspaper, magazine or online service provides such a comprehensive educational opportunity.

IBD Forums

IBD Forums is the official online message board for IBD and CAN SLIM investors. On IBD Forums, you can post, read, and reply to messages on a wide variety of investing and other related topics. You can register for free on Investors.com.

• CHAPTER •

Watching the Market and Reacting to News

Tape Reading Is Emotional

Ticker tape watching or being glued to your PC or watching the market on a TV channel all day can get dangerously emotional. Sometimes a stock keeps rising to the point where everyone—including you—is convinced it's going “straight through the roof.” That's when discipline is most needed because the stock is probably topping. When a stock's merits are so obvious that it looks fantastic to everyone, you can be sure almost everyone who can buy it has already done so. Remember, majority opinion is rarely right in the stock market.

Winners in the stock market need perspective, discipline, and self-control above all else. Those who continually sit in front of the moving ticker tape that shows many stocks as they change prices or their PC monitoring hundreds of stocks changing prices risk making emotional decisions.

Is the Stock in a Base or Is It Too Extended?

There's an easy way to keep your head if you're keeping your eye on the tape or on your PC.

When you see activity that impresses you, always refer to a weekly chart to see if the stock is building a base or if it is extended too far past its buy or pivot point. If it is extended, leave it alone; it's too late. Chasing stocks, like crime, doesn't pay.

If the stock is building a base, then apply the CAN SLIM system. Are current earnings up a meaningful amount? Is the three-year earnings record good? Use IBD's checklist for all the other CAN SLIM criteria.

More than half the stocks that look inviting on the tape will fail the CAN SLIM test and prove to be deficient, mediocre investments. However, sooner or later, convincing market action will point you to a golden opportunity that meets all your criteria for a possible star performer.

Scan Chart Books Weekly and List Your Buy Points

Another way to use market action productively is to review a comprehensive online or printed chart book or charts from a special screen every week and list stocks that meet your technical and fundamental criteria. Then jot down the buy point at which you would consider buying each stock. Also note the average daily volume for each stock on your prospect list so that you can easily verify any noteworthy increases in volume.

Keep this shopping list with you every day for the next couple of weeks as you watch the market. In time, one or two of the stocks on your list will begin to approach your buy point. This is the time to get ready to buy—when the stock trades at your buy point, you anticipate the day's volume will be at least 50% above average and the general market direction is positive. The more demand there is for a stock at the buy point, the better.

Tape and market watchers expect the pace of activity to slow down around lunchtime in New York (12 p.m. to 1 p.m. Eastern). They also know the market frequently shows its true colors in the last hour of the day, either coming on and closing strong, or suddenly weakening and failing to hold the gains established earlier in the session.

Don't Buy on Tips and Rumors

I never buy stocks on tips, rumors, or inside information. Doing so simply isn't sound. Of course, tips, rumors, and inside information are what most people are looking for. However, I should remind you again that what most people believe and do in the market doesn't work very well. Beware of falling into the typical market traps.

Certain advisory services and columns in some business newspapers are fed by Street gossip, rumors, and tips, along with planted personal opinions or inside information. These services and columns, in my opinion, are unprofessional and unsophisticated. There are far sounder and safer methods of gathering information.

Bernard Baruch stressed the importance of separating the facts of a situation from tips, "inside dope," and wishful thinking. One of his rules was to beware of barbers, beauticians, waiters, or anyone else bearing such gifts.

Watch for Distortion around the End of the Year and in Early January

A certain amount of distortion can occur in optionable stocks around option expiration dates. There's also a significant amount of year-end distortion in stocks during December and sometimes through January and early February.

Year-end is a tricky time for anyone to buy stock, since numerous trades are based on tax considerations. Many low-grade losers will suddenly seem strong, while former leaders lie idle or start to correct. In time, this misleading activity dissipates and the true leaders reemerge.

General market sell-offs also occasionally start after the beginning of a new year, which further adds to the difficulty. Fake-out action can occur with one big "up" day followed by a big "down" day, only to be followed by another big "up" day. There are times when I'd rather take a vacation in January. The January effect, where small- and mid-cap stocks get a boost during January, can be a misleading and spurious indicator. At best, it "works" for only a brief period.

It's important that you stick with your rules and don't get sidetracked by questionable, less-reliable indicators, of which there are many.

Interpret and React to Major News

When domestic or foreign news of consequence hits the street, capable market sleuths are sometimes less concerned with whether the news is good or bad than they are with analyzing its effect on the market. For example, if the news appears to be bad but the market yawns, you can feel more positive. The tape is telling you that the underlying market may be stronger than many people believe. On the other hand, if highly positive news hits the market and stocks give ground slightly, the tape analyst might conclude the underpinnings of the market are weaker than previously believed.

Sometimes the market overreacts to or even counteracts favorable or disappointing news. On Wednesday, November 9, 1983, someone ran a full-page ad in the *Wall Street Journal* predicting rampant inflation and another 1929-type depression. The ad appeared during the middle of an intermediate correction in the market, but its warnings were so overblown that the market immediately rebounded and rallied for several days.

There's also a difference between a market that retreats in the face of news that's scary but easy to understand and explain, and one that slumps noticeably on no apparent news at all.

Experienced market investigators have long memories. They keep records of past major news events and how the market reacted. The list would include President Eisenhower's heart attack, the Cuban missile crisis, the Kennedy

assassination, an outbreak of war, the Arab oil embargo, expectations of government actions such as wage and price controls, 9/11, war in the Mideast and, more recently, in early September 2008, when subprime real estate news got worse and the market expected a very liberal president to be elected.

Old News versus New News

After it's been repeated several times, both good news and bad news become old news.

Old news will often have the opposite effect on the stock market from what it had when the news first broke.

This, of course, is the opposite of how propaganda and disinformation work in totalitarian dictator-controlled countries. There, the more often a lie or distortion is repeated to the masses, the more it may become accepted as truth. Here, when news becomes widely known or anticipated, it's "discounted" by experienced individuals in the marketplace, blunting the effect of its release—unless, of course, the news keeps getting worse than expected.

To market neophytes, news can be paradoxical and confusing. For example, when a company releases a bad quarterly earnings report, its stock may go up in price when this is reported. When this occurs, it's often because the news was known or anticipated ahead of time, and a few professionals may decide to buy or to cover short sales once all the bad news is finally out. "Buy on bad news" is what some wily institutions use as a guide. Others believe they should step in and provide support for their large positions at difficult times.

Analyzing Your National News Media

How the national news is edited and presented or suppressed dramatically affects the economy and public confidence. It can also influence public opinion of the government, elections, our presidents, and our stock market.

Several excellent books have been written on the subject of analyzing our national news. Humphrey Neill, author of the 1931 classic *Tape Reading and Market Tactics*, also wrote *The Art of Contrary Opinion*. It carefully examines the way identical news stories are reported quite differently in the headlines of different newspapers and how that can be misleading to stock owners and the public. Neill developed contrarian theories based on how frequently conventional wisdom or consensus opinion expressed in the national media turns out to be ill-conceived or just plain wrong.

In 1976, media expert Bruce Herschensohn wrote *The Gods of Antenna*, which tells how some TV networks manipulate the news to influence public

opinion. Another book on the subject is *The Coming Battle for the Media*, written in 1988 by William Rusher.

One of the most outstanding studies on the subject is *The Media Elite*, written by Stanley Rothman and Robert Lichter in 1986. Rothman and Lichter interviewed 240 journalists and top staffers at three major newspapers (the *New York Times*, the *Wall Street Journal* and the *Washington Post*), three news magazines (*Time*, *Newsweek* and *U.S. News & World Report*), and the news departments of four TV networks (ABC, CBS, NBC, and PBS). On average, 85% of these top national journalists were found to be liberal and to have voted the Democratic ticket in national elections in 1964, 1968, 1972 and 1976. Another survey showed only 6% of national journalists to have voted Republican.

A Freedom Forum poll reinforced *The Media Elite* when it documented that 89%—9 out of 10—of Washington reporters and bureau chiefs voted for Clinton in 1992 and 7% voted for the first George Bush.

More recently, Tim Groseclose of UCLA and Stanford and Jeff Milyo of the University of Chicago published “A Measure of Media Bias.” They counted the number of times a news outlet quoted certain think tanks and compared this with the number of times members of Congress cited the same think tanks when speaking from the floor.

Comparing the citation patterns enabled them to construct an ADA (Americans for Democratic Action) score for each media outlet. They found that *Fox News Special Report* was the only right-of-center news outlet in their sample. The most liberal was *CBS Evening News* followed by the *New York Times*, the *Los Angeles Times*, *USA Today*, *NBC Nightly News*, and ABC’s *World News Tonight*.

More surprising was the astonishing degree that your mainstream media in these surveys are far more liberal than the general voting public.

In the 1984 presidential election, Mondale vs. Reagan, the ABC, CBS, and NBC prime-time news programs from Labor Day to Election Day were taped and dissected by Maura Clancy and Michael Robinson. They focused only on reports in which spin for or against each candidate was definite. *Public Opinion* magazine found Reagan got 7,230 seconds of bad press and only 730 of good, while Mondale enjoyed 1,330 seconds of good press and 1,050 seconds of bad.

Leading up to Reagan’s reelection run, the Institute for Applied Economics surveyed how the network news treated economic news during the strong recovery in the last half of 1983. It discovered that nearly 95% of the economic statistics were positive, yet 86% of the networks’ stories were primarily negative.

Emmy Award winner Bernard Goldberg spent nearly 30 years with CBS News. His book *Bias* documents in detail how network television has

provided one-sided news with little balance or fairness. This is a book all young people in America should read to be well informed.

Goldberg tells how journalists decide what news they want to cover and the slant they want to impart. More damaging, they determine what news to minimize or keep quiet. They take sides and assign labels to people.

MSNBC's Chris Matthews, a leading media figure, was a speechwriter for Jimmy Carter. The late Tim Russert of NBC was a political advisor to New York's governor, Mario Cuomo. ABC's Jeff Greenfield was a speechwriter for Robert Kennedy, PBS's Bill Moyers was Lyndon Johnson's press secretary, and ABC news anchor George Stephanopoulos was Clinton's communications director.

To succeed, as individual investors and a free nation, we must learn to separate facts from the personal political opinions and strong agenda-driven biases of the majority of the national media. This could be the number one problem in our country today.

In addition to one-sided bias in the national media, freedom can be jeopardized by either infiltration or propaganda designed to undermine the nation and its people. This is intended to confuse national issues; pit one group against another; stir up class envy, fear and hatred; and tear down or demean certain key people or established institutions.

The most questionable practice of the one-sided media is how they select which stories and facts to cover and continually promote. Even more important are the critically relevant stories and facts they choose not to cover because those stories or facts don't support their agenda or the slant they want the story to have.

In late 2008, public fear the recession then under way might become like the Great Depression of the 1930s escalated. Most Americans weren't even born then and know little about the period. Here are three outstanding books about the 1930s and early 1940s every American should read:

Since Yesterday, The 1930s in America by Frederick Allen, gives a good account of what happened in that period. *The Life & Death of Nazi Germany*, by Robert Goldston, covers Hitler and the rapid rise of the Nazis from the late 1920s to the end of World War II. *Masters of Deceit* by former FBI Director J. Edgar Hoover, covers how communism functions and operates. A well-informed and aware nation will protect and defend its freedoms.

It's Not Like 1929, It's 1938

I've overlayed a chart of the Nasdaq Composite Index from the "Anything Goes 1990s" through March 2009 over the Dow Jones Industrials in the

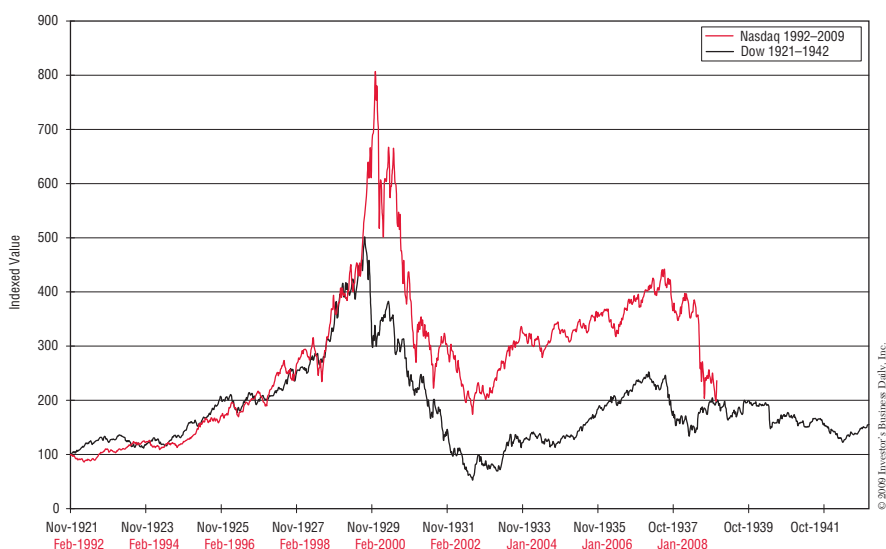
Roaring 1920s and the Depression era of the 1930s. They are almost exact duplicates. The Nasdaq was used because it trades more volume now than the NYSE and represents more entrepreneurial new America companies that have driven our markets in recent years. The Nasdaq from September 1998 to the wild peak in March 2000 actually soared 2.5 times the Dow's 1928–1929 climax run-up. The Nasdaq dot-com bubble was like the tulip bulb mania of 1636 in Holland. The Nasdaq declined 78% whereas the Dow's 1929 crash declined 89%.

The reason history repeats in this amazing manner is the market is made up of supply and demand and millions of people acting almost 100% on human emotions. It's crowd psychology: human hopes, desires, fears, pride, and ego behind so many decisions. Human nature is pretty much the same today as it was in 1929. These two periods happened 70 years apart, about a lifetime. So, few people today know what happened then. Like now, the banks had excessive loans, then to farmers, plus stocks were bought on excessive leverage. Unemployment at the Depression lows in 1932 peaked at 25% but was still 20% in 1939 just before WWII began.

The rally from the 1932 low to the 1936–1937 peak lasted the same amount of time as our Nasdaq rally back from the low of 2002 to 2007 . . . and then both fell around 50% to 60%.

History is now on the march, but it's not like 1929, it's like 1938.

So, what was happening leading up to 1938?



Nasdaq Composite February 1992–March 2009 compared to Dow Jones Industrials November 1921–December 1942.

The Nazi party in 1930 won 107 seats in the Reichstag. Hitler became Chancellor of Germany in January 1933. He already had his storm troopers and the Hitler youth. Only months later, the Reichstag gave Hitler all its constitutional powers. By July, all other political parties were outlawed. Hitler kept saying he was only interested in peace. His speeches were grandiose promises that enthralled the German people.

By 1938, Britain and France negotiated with Hitler and tried to appease him by making concessions. Britain believed they had a peace agreement with Hitler, "Peace in our time." The crowds cheered. In Parliament, Churchill said, "We've suffered a defeat." No one believed him. He was booed. World War II began in 1939. Germany rolled over France in only a few weeks.

Today, Iran is a key sponsor of terrorist organizations and will have nuclear weapons very soon plus the missile ability to deliver them. Have we learned anything from history in the 1930s? Will we repeat Neville Chamberlain's mistaken belief in a phony agreement on a piece of paper?

I'm including two editorials by Thomas Sowell, whom I mentioned earlier in Chapter 16. His work always shows important facts and wisdom.

Roman Empire Outlasted U.S., But It Too Fell

December 9, 2008

THOMAS SOWELL

Will the horrors unleashed by Islamic terrorists in Mumbai cause any second thoughts by those who are so anxious to start weakening the American security systems currently in place, including government interceptions of international phone calls and the holding of terrorists at Guantanamo?

Maybe. But never underestimate partisan blindness in Washington or in the mainstream media where, if the Bush administration did it, then it must be wrong.

Contrary to some of the more mawkish notions of what a government is supposed to be, its top job is the protection of the people. Nobody on 9/11 would have thought that we would see nothing comparable again in this country for seven long years.

Many people seem to have forgotten how, in the wake of 9/11, every great national event—the World Series, Christmas, New Year's, the Super Bowl—was under the shadow of a fear that this was when the terrorists would strike again.

They didn't strike again here, even though they have struck in Spain, Indonesia, England and India, among other places. Does anyone imagine that this was because they didn't want to hit America again?

Could this have had anything to do with all the security precautions that liberals have been complaining about so bitterly, from the interception of international phone calls to forcing information out of captured terrorists?

Too many people refuse to acknowledge that benefits have costs, even if that cost means only having no more secrecy when making international phone calls than you have when sending e-mails, in a world where computer hackers abound. There are people who refuse to give up anything, even to save their own lives.

A very shrewd observer of the deterioration of Western societies, British writer Theodore Dalrymple, said: "This mental flabbiness is decadence, and at the same time a manifestation of the arrogant assumption that nothing can destroy us."

There are growing numbers of things that can destroy us. The Roman Empire lasted a lot longer than the United States has lasted, and yet it too was destroyed.

Millions of lives were blighted for centuries thereafter, because the barbarians who destroyed Rome were incapable of replacing it with anything at all comparable. Neither are those who threaten to destroy the United States today.

The destruction of the United States will not require enough nuclear bombs to annihilate cities and towns across America. After all, the nuclear destruction of just two cities was enough to force Japan to surrender—and the Japanese had far more willingness to fight and die than most Americans have today.

How many Americans are willing to see New York, Chicago and Los Angeles all disappear in nuclear mushroom clouds, rather than surrender to whatever outrageous demands the terrorists make?

Neither Barack Obama nor those with whom he will be surrounded in Washington show any signs of being serious about forestalling such a terrible choice by taking any action with any realistic chance of preventing a nuclear Iran.

Once suicidal fanatics have nuclear bombs, that is the point of no return. We, our children and our grandchildren will live at the mercy of the merciless, who have a track record of sadism.

There are no concessions we can make that will buy off hate-filled terrorists. What they want—what they must have for their own self-respect, in a world where they suffer the humiliation of being visibly centuries behind the West in so many ways—is our being brought down in humiliation, including self-humiliation.

Even killing us will not be enough, just as killing Jews was not enough for the Nazis, who first had to subject them to soul-scarring humiliations and dehumanization in their death camps.

This kind of hatred may not be familiar to most Americans but what happened on 9/11 should give us a clue—and a warning.

The people who flew those planes into the World Trade Center buildings could not have been bought off by any concessions, not even the hundreds of billions of dollars we are spending in bailout money today.

They want our soul—and if they are willing to die and we are not, they will get it.

False Solutions and Real Problems

March 17, 2009

THOMAS SOWELL

Someone once said that Senator Hubert Humphrey, liberal icon of an earlier generation, had more solutions than there were problems.

Senator Humphrey was not unique in that respect. In fact, our present economic crisis has developed out of politicians providing solutions to problems that did not exist—and, as a result, producing a problem whose existence is all too real and all too painful.

What was the problem that didn't exist? It was a national problem of unaffordable housing. The political crusade for affordable housing got into high gear in the 1990s and led to all kinds of changes in mortgage lending practices, which in turn led to a housing boom and bust that has left us in the mess we are now trying to dig out of.

Usually housing affordability is measured in terms of how much of the average person's income it takes to cover either apartment rent or a monthly mortgage payment.

There were certainly places here and there where it took half a family's income just to put a roof over their heads. Many such places were in coastal California but there were a few others, here and there, on the east coast and elsewhere.

But, vast areas of the country in between—"flyover country" to the east coast and west coast elites—had housing prices that took no larger share of the average American's income than in the decade before the affordable housing crusade got under way.

Why then a national crusade by Washington politicians over local problems? Probably as good an answer as any is that "It seemed like a good idea at the time." How are we to be kept aware of how compassionate and how important our elected officials are unless they are busy solving some problem for us?

The problem of skyrocketing housing prices was all too real in those places where this problem existed. When you have to live on half your income because the other half goes for housing, that's a real downer.

Almost invariably, these severe local problems had local causes—usually severe local restrictions on building homes. These restrictions had a variety of

politically attractive names, ranging from “open space” laws and “smart growth” policies to “environmental protection” and “farmland preservation.”

Like most wonderful-sounding political slogans, none of these lofty goals was discussed in terms of that one four-letter word that people do not use in polite political society—“cost.”

No one asked how many hundreds of thousands of dollars would be added to the cost of an average home by “open space” laws, for example. Yet empirical studies have shown that land-use restrictions added at least a hundred thousand dollars to the average home price in dozens of places around the country.

In some places, such as coastal California, these restrictions added several hundred thousand dollars to the price of the average home.

In other words, where the problem was real, local politicians were the cause. National politicians then tried to depict this as a national problem that they would solve.

How would they solve it? By pressuring banks and other lenders to lower their requirements for making mortgage loans, so that more people could buy houses. The Department of Housing and Urban Development gave the government-sponsored enterprise Fannie Mae quotas for how many mortgages it should buy that were made out for people with low to moderate incomes.

Like most political “solutions,” the solution to the affordable housing “problem” took little or no account of the wider repercussions this would entail.

Various economists and others warned repeatedly that lowered lending standards meant more risky mortgages. Given the complex relationships among banks and other financial institutions, including many big Wall Street firms, if mortgages started defaulting, all the financial dominoes could start falling.

These warnings were brushed aside. Politicians were too busy solving a national problem that didn’t exist. In the process, they created very real problems. Now they are offering even more solutions that will undoubtedly lead to even bigger problems.

For more information on how politicians in our government were the real cause behind our worst financial crisis since 1938, Thomas Sowell has authored a short easy to read, but historically invaluable book entitled, *The Housing Boom and Bust*. It’s a must read for all investors, consumers, and voters affected by the resulting mess of the 2008 massive financial market meltdown.

Sowell’s latest (2010) master stroke, *Intellectuals and Society*, examines the track record of intellectuals in the things they have advocated and surprisingly how often they have been proved not only wrong, but grossly and disastrously wrong in their prescriptions for the ills of society—and how little their views have changed in response to empirical evidence of the disasters their views caused.

10

• CHAPTER •

How You Could Make Your Million Owning Mutual Funds

What Are Mutual Funds?

A mutual fund is a diversified portfolio of stocks managed by a professional investment company, usually for a small management fee. Investors purchase shares in the fund itself and make or lose money based on the combined profits and losses of the stocks within the fund.

When you purchase a mutual fund, what you're buying is long-term professional management to make decisions for you in the stock market. You should probably handle a mutual fund differently from the way you handle individual stocks.

A stock may decline and never come back in price. That's why you must *always* have a loss-cutting policy. In contrast, a well-selected, diversified domestic growth-stock fund run by an established management organization will, in time, always recover from the steep corrections that naturally occur during bear markets. The reason mutual funds come back is that they are broadly diversified and generally participate in each recovery cycle in the U.S. economy.

How to Become a Millionaire the Easy Way

Mutual funds are outstanding investment vehicles if you learn how to use them correctly. However, many investors don't understand how to manage them to their advantage.

The first thing to understand is that the big money in mutual funds is made by owning them through several business cycles (market ups and downs). This means 15, 20, or 25 years or longer. Sitting tight for that long requires enormous patience and confidence. It's like real estate. If you buy a house, then get nervous and sell out after only three or four years, you may not make anything. It takes time for your property to appreciate.

Here's how I believe you, as a shrewd fund investor, should plan and invest. Pick a diversified domestic growth fund that performed in the top quartile of all mutual funds over the last three or five years. It will probably have an average annual rate of return of about 15% or 20%. The fund should also have outperformed many other domestic growth-stock funds in the latest 12 months. You'll want to consult a reliable source for this information. Many investment-related magazines survey fund performance every quarter. Your stockbroker or library should have special fund performance rating services so you can get an unbiased review of the fund you're interested in purchasing.

Investor's Business Daily rates mutual funds based on their 36-month performance records (on a scale from A+ to E) and also provides other performance percentages based on different time periods. Focus your research on mutual funds with an A+, A, or A- performance rating in IBD. During a bear market, growth fund ratings will be somewhat lower. The fund you pick does not have to be in the top three or four in performance each year to give you an excellent profit over 15 years or more.

You should also reinvest your dividends and capital gains distributions (profits derived from a mutual fund's sales of stocks and bonds) to benefit from compounding over the years.

The Magic of Compounding

The way to make a fortune in mutual funds is through compounding. Compounding occurs when your earnings themselves (the performance gains plus any dividends and reinvested capital) generate more earnings, allowing you to put ever-greater sums to work. The more time that goes by, the more powerful compounding becomes.

In order to get the most benefit from compounding, you'll need a carefully selected growth-stock fund, *and* you'll need to stick with it over time. For example, if you purchase \$10,000 of a diversified domestic growth-stock fund that averages about 15% a year over a period of 35 years, here is an approximation of what the result might be, compliments of the magic of compounding:

First five years: \$10,000 might become \$20,000

Next five years: \$20,000 might become \$40,000

Next five years: \$40,000 might become \$80,000

Next five years: \$80,000 might become \$160,000

Next five years: \$160,000 might become \$320,000

Next five years: \$320,000 might become \$640,000

Next five years: \$640,000 might become **\$1.28 million!**

Suppose you also added \$2,000 each year and let it compound as well.

Your total could possibly then come to more than \$3 million!

Now, how much more do you think you'd have if you also bought a little extra during every bear market of 6 to 12 months while the fund was temporarily down 30% or more from its peak?

Nothing's ever guaranteed in this world, and, yes, there are always taxes. However, this example is representative of how the better growth funds have performed over the last 50 years, and what could happen to you if you plan and invest in mutual funds correctly. Over any 20- to 25-year period, your growth fund should average two to three times what a savings account would return. It's definitely possible.

When Is the Best Time to Buy a Fund?

Anytime is the best time. You'll never know what the perfect time is, and waiting will usually result in your paying a higher price. You should focus on getting started and becoming regular and relentless about building capital that can compound over the years.

How Many Funds Should You Own?

As time passes, you may discover you'd like to develop an additional long-term program. If so, do it. In 15 years, you might have hefty amounts in two or even three funds. However, don't overdo it. There's no reason to diversify broadly in mutual funds. Individuals with multimillion-dollar portfolios could spread out somewhat further, allowing them to place sums into a more diverse group of funds. To do this correctly, you need to make some attempt to own funds with different management styles. For example, you could divvy up your money among a value-type growth fund, an aggressive growth fund, a mid- to large-cap growth fund, a small-cap fund, and so on. Many fund organizations, including Fidelity, Franklin Templeton, American

Century, and others, offer funds with varied objectives. In most cases, you have the right to switch to any other fund in the family at a nominal transfer fee. These families offer you added flexibility of making prudent changes years later if you want an income or balanced fund.

Are Monthly Investment Plans for You?

Programs that automatically withhold money from your paycheck are usually sound if you deposit that money in a carefully selected, diversified domestic growth-stock fund. However, it's best to also make a larger initial purchase that will get you on the road to serious compounding all that much quicker.

Don't Let the Market Diminish Your Long-Term Resolve

Bear markets can last from six months to, in some rare cases, two or three years. If you're going to be a successful long-term investor in mutual funds, you'll need the courage and perspective to live through many discouraging bear markets. Have the vision to build yourself a great long-term growth program, and stick to it. Each time the economy goes into a recession, and the newspapers and TV are saying how terrible things are, consider *adding* to your fund when it's 30% or more off its peak. You might go so far as to borrow a little money to buy more if you feel a bear market has ended. If you're patient, the price should be up nicely in two or three years.

Growth funds that invest in more aggressive stocks should go up more than the general market in bull phases, but they will also decline more in bear markets. Don't be alarmed. Instead, try to look ahead several years. Daylight follows darkness.

You might think that buying mutual funds during periods like the Great Depression would be a bad idea because it would take you 30 years to break even. However, on an inflation-adjusted basis, had investors bought at the exact top of 1929, they would have broken even in just 14 years, based on the performance of the S&P 500 and the DJIA. Had these investors bought at the top of the market in 1973, they would have broken even in just 11 years. If, in addition, they had dollar cost averaged throughout these bad periods (meaning they had purchased additional shares as the price went down, lowering their overall cost per share), they would have broken even in half the time.

The 1973 drop in the Nasdaq from the peak of 137 would have been recovered in 3½ years, and as of February 2009, the Nasdaq average had recovered from 137 to 1,300. Even during the two worst market periods in

history, growth funds did bounce back, and they did so in less time than you'd expect. In other words, if you took the absolutely worst period of the twentieth century, the Great Depression, and you bought at the top of the market, then dollar cost averaged down, at worst, it would have taken you seven years to break even, and over the following 21 years, you would have seen your investment increase approximately eight times. This is compelling evidence that dollar cost averaging into mutual funds and holding them for the long haul could be smart investing.

Some people may find this confusing, since we have said that investors should never dollar cost average down in stocks. The difference is that a stock can go to zero, while a domestic, widely diversified, professionally managed mutual fund will find its way back when the market eventually gets better, often tracking near the performance of benchmarks like the S&P 500 and the Dow Jones Industrial Average.

The super-big gains from mutual funds come from compounding over a span of many years. Funds should be an investment for as long as you live.

They say diamonds are forever. Well, so are your funds. So buy right and sit tight!

Should You Buy Open- or Closed-End Funds?

“Open-end” funds continually issue new shares when people want to buy them, and they are the most common type. Shares are normally redeemable at net asset value whenever the present holders wish to sell.

A “closed-end” fund issues a fixed number of shares. Generally, these shares are not redeemable at the shareholder's option. Redemption takes place through secondary market transactions. Most closed-end fund shares are listed for trading on exchanges.

Better long-term opportunities are found in open-end funds. Closed-end funds are subject to the whims and discounts below book value of the auction marketplace.

Should You Buy Load or No-Load Funds?

The fund you choose can be a “load” fund, where a sales commission is charged, or a “no-load” fund. Many people prefer no-loads. If you buy a fund with a sales charge, discounts are offered based on the amount you invest. Some funds have back-end loads (sales commissions that are charged when withdrawals are made, designed to discourage withdrawals) that you may also want to take into consideration when evaluating a fund for purchase. In any event, the commission on a fund is much less than the markup

you pay to buy insurance, a new car, a suit of clothes, or your groceries. You may also be able to sign a letter of intent to purchase a specified amount of the fund, which may allow a lower sales charge to apply to any future purchases made over the following 13 months.

Few people have been successful in trading no-load growth funds aggressively on a timing basis, using moving average lines and services that specialize in fund switching. Most investors shouldn't try to trade no-load funds because it's easy to make mistakes in the timing of buy and sell points. Again, get aboard a mutual fund for the long term.

Should You Buy Income Funds?

If you need income, you may find it more advantageous *not* to buy an income fund. Instead, you should select the best fund available and set up a withdrawal plan equal to 1½% per quarter, or 6% per year. Part of the withdrawal will come from dividend income received and part from your capital. If you selected the fund correctly, it should generate enough growth over the years to more than offset annual withdrawals of 6% of your total investment.

Should You Buy Sector or Index Funds?

Steer away from funds that concentrate in only one industry or area. The problem with these funds is that sectors go into and out of favor all the time. Therefore, if you buy a sector fund, you will probably suffer severe losses when that sector is out of favor or a bear market hits, unless you decide to sell it if and when you have a worthwhile gain. Most investors don't sell and could end up losing money, which is why I recommend not purchasing sector funds. If you're going to make a million in mutual funds, your fund's investments should be diversified for the long term. Sector funds are generally not a long-term investment.

If you are conservative, it may be OK for you to pick an index fund, where the fund's portfolio closely matches that of a given index, like the S&P 500. Index funds have outperformed many actively managed funds over the long run. I tend to prefer growth funds.

Should You Buy Bond or Balanced Funds?

I also don't think most people should invest in bond or balanced funds. Stock funds generally outperform bond funds, and when you combine the two, you're ultimately just watering down your results. However, someone

who is in retirement might want to consider a balanced fund if less volatility is desired.

Should You Buy Global or International Funds?

These funds might provide some diversification, but limit the percentage of your total fund investment in this higher-risk sector to 10% or 15%. International funds can, after a period of good performance, suffer years of lag-gard results, and investing in foreign governments creates added risk. Historically, Europe and Japan have underperformed the U.S. market.

The Size Problem of Large Funds

Asset size is a problem for many funds. If a fund has billions of dollars in assets, it will be more difficult for the fund manager to buy and sell large positions in a stock. Thus, the fund will be less flexible in retreating from the market or in acquiring meaningful positions in smaller, better-performing stocks. For this reason, I'd avoid most of the largest mutual funds. If you have one of the larger funds that's done well over the years, and it is still doing reasonably well despite having grown large, you should probably sit tight. Remember, the big money is always made over the long haul. Fidelity Contrafund, run by Will Danoff, has been the best-managed large fund for a number of years.

Management Fees and Turnover Rates

Some investors spend a lot of time evaluating a fund's management fees and portfolio turnover rates, but in most cases, such nitpicking isn't necessary.

In my experience, some of the best-performing growth funds have higher turnover rates. (A portfolio turnover rate is the ratio of the dollar value of buys and sells during a year to the dollar value of the fund's total assets.) Average turnover topped 350% in the Fidelity Magellan Fund during its three biggest performance years. CGM Capital Development Fund, managed by Ken Heebner, was the top-performing fund from 1989 to 1994. In two of those years, 1990 and 1991, it had turnover rates of 272% and 226%, respectively. And Heebner's superior performance even later in CGM Focus fund was concentrated in 20 stocks that were actively managed.

You can't be successful and on top of the market without making any trades. Good fund managers will sell a stock when they think it's overvalued, when they are worried about the overall market or a specific group, or when they find another, more attractive stock to purchase. That's what you hire a

professional to do. Also, the institutional commission rates that funds pay are extremely low—only a few cents per share of stock bought or sold. So don't be overly concerned about turnover rates. It's the fund's overall performance over several years that is key.

The Five Most Common Mistakes Mutual Fund Investors Make

- 1.** Failing to sit tight for at least 15 years or more
- 2.** Worrying about a fund's management fee, its turnover rate, or the dividends it pays or buying new funds or last year's #1 fund
- 3.** Being affected by news in the market when you're supposed to be investing for the long term
- 4.** Selling out during bad markets or switching funds too often
- 5.** Being impatient and losing confidence too soon

Other Common Mistakes

Typical investors in mutual funds tend to buy the best-performing fund after it's had a big year. What they don't realize is that history virtually dictates that in the next year or two, that fund will probably show much slower results. If the economy goes into a recession, the results could be poorer still. Such conditions are usually enough to scare off those with less conviction and those who want to get rich quick.

Some investors switch (usually at the wrong time) to another fund that someone convinces them is much safer or that has a "hotter" recent performance record. Switching may be OK if you have a really bad fund or if you're in the wrong type of fund, but too much switching quickly destroys what must be a long-term commitment to the benefits of compounding.

America's long-term future has always been a shrewd investment. The U.S. stock market has been growing since 1790, and the country will continue to grow in the future, in spite of wars, panics, and deep recessions. Investing in mutual funds—the right way—is one way to benefit from America's growth and to secure your and your family's long-term, 20-plus-year financial future.

How to Use IBD to Buy ETFs

To be perfectly honest, I'm not a big fan of exchange-traded funds because I think you can make more money by focusing on the market leaders. But because ETFs had become so wildly popular with not only individual

investors but also asset managers, we started covering ETFs in February 2006.

ETFs are basically mutual funds that trade like a stock, but offer transparency, tax efficiency, and lower expenses.

While mutual funds set their prices or net asset value (NAV) once a day, the prices of ETFs jump up and down throughout the day, just like a stock price. Anything you can do with a stock, you can do with an ETF, such as selling short and trading options.

ETFs are more tax-friendly than mutual funds because of what happens under the hood. When market makers need to create or redeem shares, they round up the underlying stocks and trade them with the provider for new ETF shares. They do the opposite to redeem ETF shares for the underlying stocks. No money changes hands because the shares are traded in-kind.

Unlike mutual funds, ETFs are not affected by shareholder redemptions. If too many investors pull money out of mutual funds, fund managers may be forced to sell the stocks they hold to raise cash, thereby incurring a taxable event. ETFs keep trading to a minimum, so there are few taxable gains.

ETFs charge management fees of anywhere from 0.10% to 0.95%. That's considerably smaller than those of mutual funds, which charge 1.02% on average.¹

However, with a good mutual fund, you're getting a top-notch manager who makes investment decisions for you. An ETF requires that you pull the buy and sell triggers.

Don't kid yourself that the diversification in an ETF will somehow protect you. Take the SPDR Financial Sector (XLF). In the banking meltdown in 2008, this ETF plunged 57%.

The SPDR (SPY), which tracks the S&P 500, was the first U.S.-listed ETF. It started trading on the Amex in 1993. The Nasdaq 100, known today as PowerShares QQQQ Trust (QQQQ), and the Diamonds Trust (DIA), which tracks the Dow Jones Industrial Average, were both launched in the late 1990s.

Today, there are ETFs tracking not only benchmark indexes, but also bonds, commodities, currencies, derivatives, carbon credits, investment strategies such as low-P/E stocks, and more. In 2007 and 2008, ETF launches were what IPOs were to the Internet bubble. Providers floated ETFs based on esoteric indexes that diced sectors into ridiculous slices such as Wal-Mart suppliers, spin-offs, companies with patents, those that don't do any business with Sudan, and those engaged in "sinful" activities like gambling, alcohol, and tobacco.

¹ *Investment Company Fact Book* (Investment Company Institute, 2008).

ETFs have changed the way many people trade, although not always for the better. They offer average investors access to foreign markets such as India, which limits foreign investors. They also let you trade commodities and currencies without having to open a separate futures or foreign exchange trading account. And the advent of inverse ETFs lets those with accounts that prohibit shorting to put on a short position by buying long.

Since February 2004, ETFs have accounted for from 25% to as much as 44% of the monthly trading volume on the NYSE Arca.

Top-Down Selection

IBD lists the 350 ETFs with the highest 50-day average volume and categorizes them by U.S. Stock Indexes, Sector/Industry, Global, Bonds/Fixed Income, and Commodities and Currencies. Within each category, they're listed by our proprietary Relative Strength rating in descending order. Ranking ETFs by RS highlights the leaders within each category and helps you compare them. The tables also list year-to-date return, Accumulation/Distribution rating, dividend yields, the prior day's closing price, the price change, and the change in volume versus the daily average.

Aside from reading IBD's ETF coverage, monitor the "Winners & Losers" table on the exchange-traded funds page. Every day it lists the leaders and laggards over a given time period, which is rotated daily:

Monday: one-week percentage change

Tuesday: one-month percentage change

Wednesday: three-month percentage change

Thursday: six-month percentage change

Friday: twelve-month percentage change

Owning Both Mutual Funds and a Stock Portfolio

Many smart investors own both funds and stocks. If you have learned how to manage your stock portfolio with skill using all the CAN SLIM buy and sell rules, you should be showing improved, superior results during each bull market and moving out of most stocks in the early phase of each bear market.

10

• CHAPTER •

Institutional Portfolio Ideas

The 31-year performance graph from inception of our weekly Leaders and Laggards

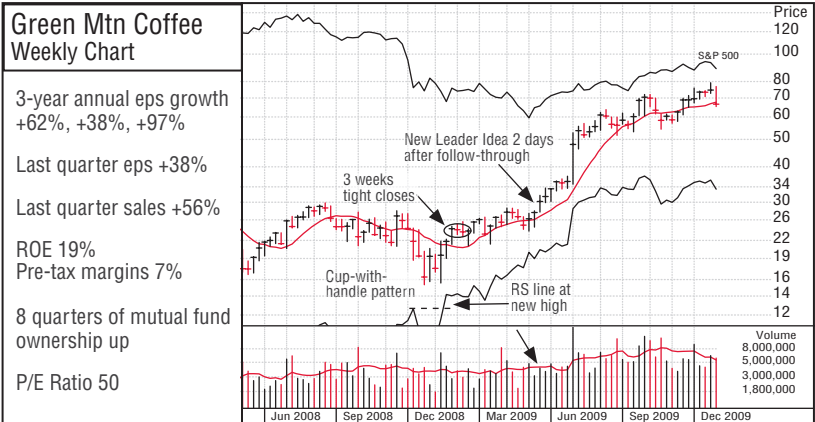
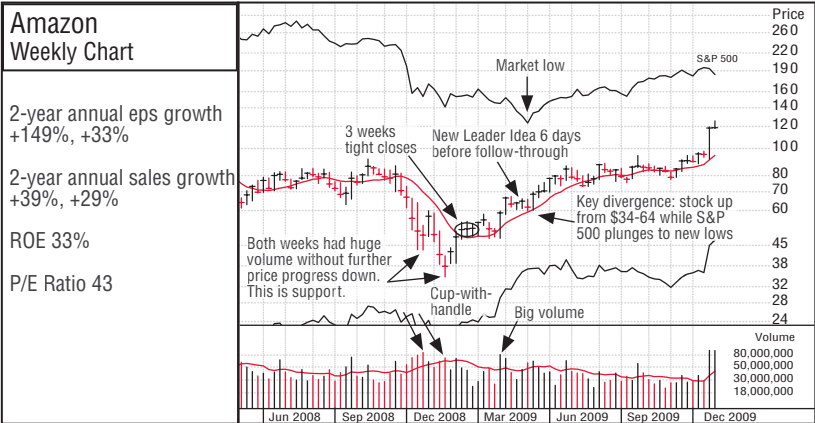
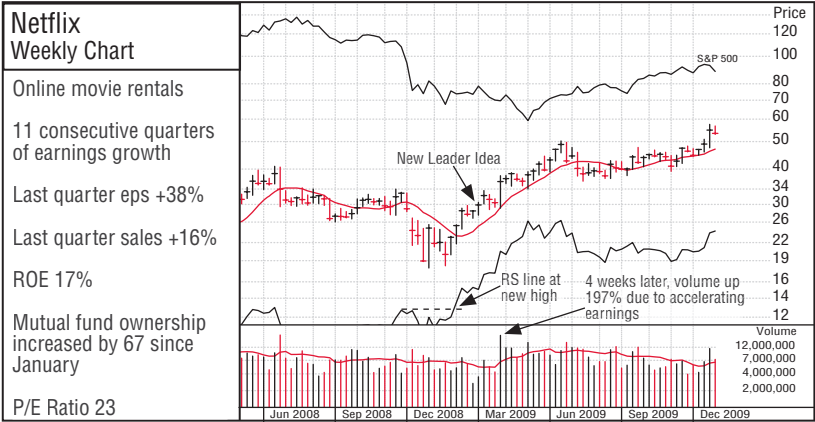
Institutional Service is shown in this chapter. It proves what is potentially possible over a long period if you concentrate on innovative new entrepreneurial leaders that have a unique new product that's better, faster, or cheaper than others in their field . . . and you face up to and eliminate your laggards and possible mistakes before they are allowed to deteriorate into huge losses.

Here are 10 charts of many of the better performers with annotations showing key facts known at the time each stock was first added to our service in, around, and following the general market follow-through of the March 12, 2009 market bottom.

You'll note, half of these stocks, after the third or fourth worst market collapse in 100 years, had an average P/E ratio over 45, 6 of these innovators had an average return on equity of 45%, and all 10 averaged having their IPO in just the last 12 years.

Most averaged earnings up 40% in their latest quarter plus powerful earnings growth in the prior two or three years. All had unique industry leading products. So, you see . . . the winner's secret is to always insist on and combine outstanding fundamentals together with sound chart patterns under accumulation during an uptrending general market.

The 2008 bear market was twice as long and deep as typical bears. The S&P 500 fell 58% in 17 months. Nearly all stocks were therefore coming up off the bottom of 50% to 80% or 90% declines. So, Amazon, Vistaprint, Priceline, Baidu, and Ctrip were all "potential deep cup-with-handle bases," just starting up the right side of a cup, somewhat like Xerox in June 1962.



Cerner Weekly Chart

3-year annual eps growth
+26%, +18%, +34%

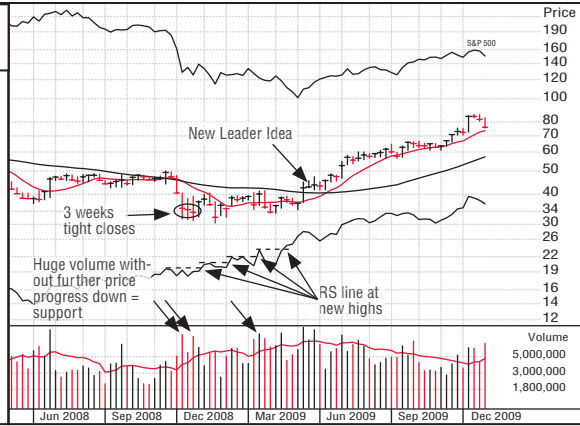
Last 2 quarters eps
+42%, +25%

Last 2 quarters sales
+13%, +18%

ROE 15%
Pre-tax margins 17%

R&D 16%; Debt 8%;
Beta 0.73

P/E Ratio 20



Vistaprint Weekly Chart

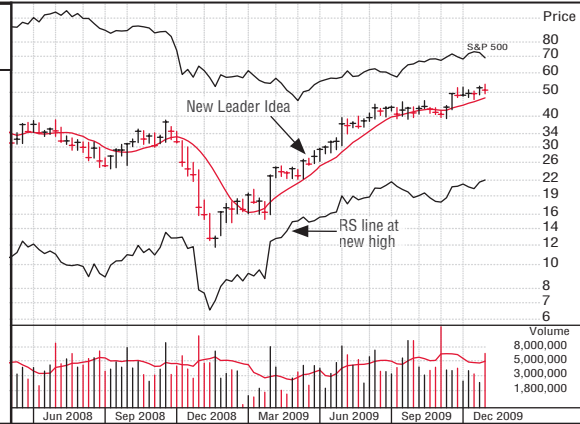
2-year annual eps growth
+44%, +51%

Last 2 quarters eps
+36%, +66%

Last 2 quarters sales
+44%, +32%

ROE 26%
Pre-tax margins 15%
Debt 8%

P/E Ratio 17



Cree Weekly Chart

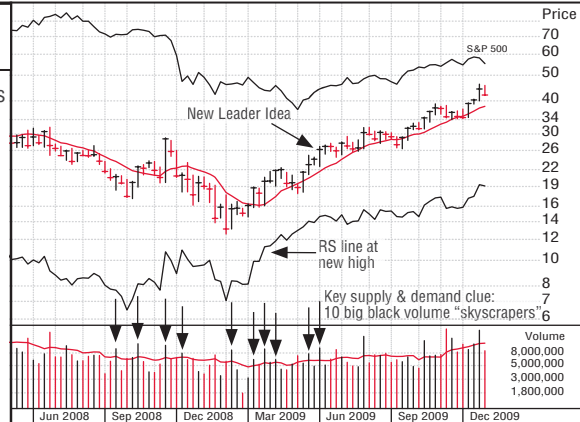
Outdoor LED lighting chips
Cyclical turnaround
situation

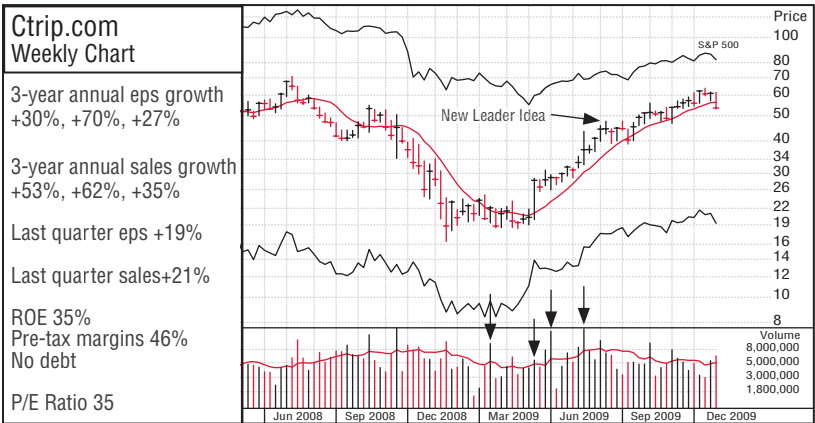
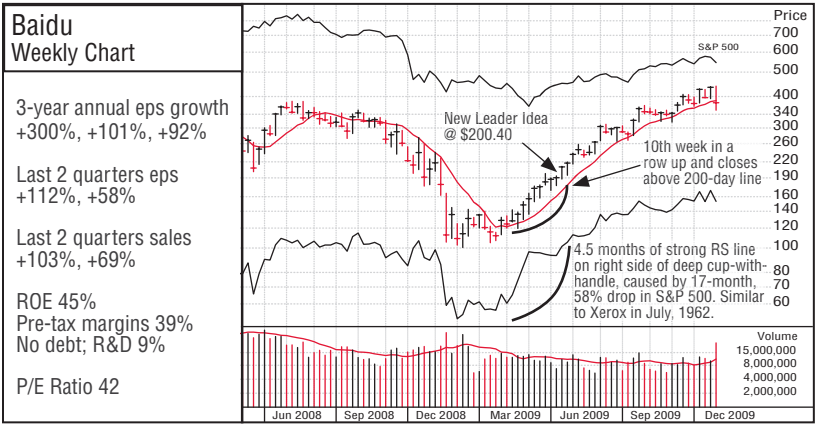
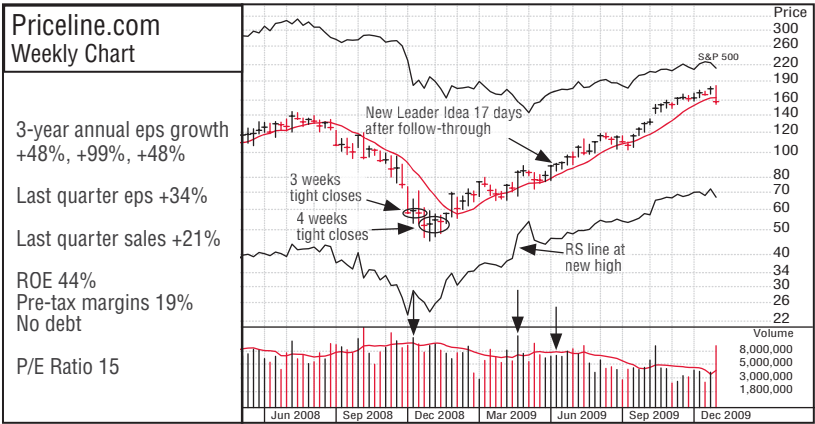
Last 5 quarters eps up
Last 2 quarters eps
+50%, +43%

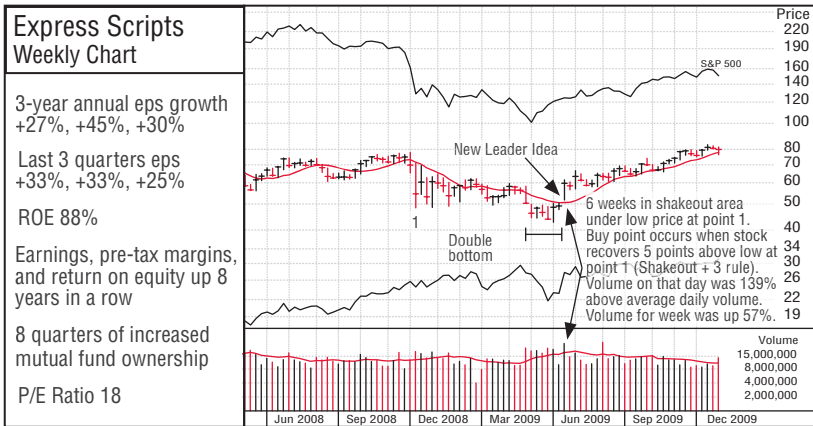
Last 2 quarters sales
+24%, +24%

Pre-tax margins 12%
No debt

P/E Ratio 41







Institutional Investors: An Overview

In 1929, the public was heavily involved in stocks, speculating with 10% cash and 90% margin. This is one reason why so many people got hurt when the market collapsed . . . they had too much debt.

However, margin debt as a percentage of market capitalization of NYSE stocks also reached an extreme level at the end of March 2000.

Banks in 1929 also had huge mortgage debt. This time around, banks had lower-quality mortgage debt. However, this subprime debt was strongly mandated and pursued by our key politicians in government from 1995 on, something they don't want to admit as they investigate and blame everyone else rather than take responsibility for their major role in creating the subprime loan 2008 financial crisis. Great government intention—catastrophic results.

The First Datagraph Books Evolve into WONDA

The first product we developed for institutional investors was the O'Neil Database Datagraph books, which contain extremely detailed charts on thousands of publicly traded companies. They were the first of their kind and represented an innovation in the institutional investment world.

We were able to produce these books at timely weekly intervals, updating them at market close every Friday. These comprehensive books were delivered to institutional money managers over the weekend in time for Monday's market open. This quick turnaround (for its time) was achieved not only because of the equity database we compiled and maintained on a daily basis, but also because of our high-speed microfilm plotting equipment. In 1964, this costly computer machinery was so new no one knew how to get a graph out of it. Once this barrier was cleared, it was possible to turn out complex, updated graphs through an automated process, at the rate of one per second.

Today, the technology has advanced so far that we can generate the most complex stock datagraphs with hardly a second thought, and the O'Neil Database books became a mainstay at many leading mutual funds around the globe. Initially, each Datagraph displayed price and volume information, along with a few technical and fundamental data items. Today, each Datagraph displays 96 fundamental and 26 technical items, and these are available for more than 8,000 stocks in 197 proprietary industry groups. This means an analyst or portfolio manager can quickly compare any company to any other, either in the same industry or in the entire database.

We still offer the O'Neil Database books, with their 600 pages of Datagraphs, to our institutional clients as part of our overall institutional investment business. With the advent of the Internet and highly sophisticated computer technology, however, these old-technology, hard-copy books are being replaced by our most innovative flagship service, WONDA. WONDA stands for William O'Neil Direct Access, and it provides institutional clients with a direct interface to the O'Neil Database. The O'Neil Database now contains more than 3,000 technical and fundamental data items on more than 8,000 U.S. stocks, and WONDA allows users to screen and monitor the database using any combination of these data items.

We originally developed WONDA as an in-house system to manage our own money. In the 1990s, after years of real-time use and refinement, the service was rolled out as the newest William O'Neil + Co. service, available to the professional and institutional community.

Because WONDA was conceived and created by our in-house portfolio managers and computer programmers, the service was designed with the serious institutional money manager in mind. Institutional money managers must frequently make rapid decisions while under pressure, and WONDA offers a wide range of features that allows instantaneous access to and monitoring of crucial stock data and related information as the market is moving.

Some of our institutional clients who use WONDA say they can "practically print money" with the system. These clients run the gamut from very conservative value-type managers to hedge fund managers. Clearly, no computer system can print money, but that type of comment from some of our biggest and best institutional clients points out the functionality and effectiveness of WONDA.

Interpreting Dome Petroleum's Datagraph

The accompanying Datagraph of Dome Petroleum is marked up to highlight a few of the ways we interpret and use this display of fundamanetal and technical information. We suggested Dome to institutions in November

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**Only 11% off old high price
after 10 months of bear market drop.**



Last time Canadian oils had big move, Boston Mutual Funds bought Dome Petroleum, Canadian Superior and Pacific Petroleum (should return to ones they know).

1977 at \$48. Fund managers didn't like the idea, so we bought the stock ourselves. Dome became one of our biggest winners at that time. This and the following case studies are real-life examples of how it's actually done.

The Pic 'N' Save Story

In July 1977, we suggested a stock no institution would touch: Pic 'N' Save. Most money managers felt the company was entirely too small because it traded only 500 shares a day, so we began purchasing it several months later. We had successful historical computer models of Kmart in 1962, when it traded only 1,000 shares a day, and Jack Eckerd Drug in April 1967, when it traded 500 shares a day, so we knew, based on its excellent fundamentals, Pic 'N' Save could become a real winner.

Precedent was with us. Both Kmart and Eckerd had become big winners after they were discovered. Average daily volume increased steadily. The same thing occurred with Pic 'N' Save. This little, unknown company, headquartered in Carson, California, turned in a steady and remarkable performance for seven or eight years. In fact, Pic 'N' Save's pretax margins, return on equity, annual earnings growth rate, and debt-to-equity ratio were at that time superior to those of other, more widely accepted institutional growth favorites—such as Wal-Mart Stores—that we had also suggested.

I've always thought of finding an outstanding stock and buying it every point on the way up. That's almost what happened with Pic 'N' Save. We bought it almost every point or two for several years. I liked the company because it gave a way for families of meager means to buy the necessities of life at exceptionally low prices. All told, we bought Pic 'N' Save on 285 different days and held it for 7½ years. When we finally sold it, while it was still advancing, our sale did not affect the market. Early purchases showed more than a 10-fold gain.

Radio Shack's Charles Tandy

We first uncovered Tandy Corp. in 1967, but we were able to convince only two institutions to buy the stock. Among the reasons given for not buying it were that it didn't pay a dividend and Charles Tandy was just a promoter. (Qualcomm was another stock considered to be too promotional from 1996 to 1998. We picked it up straight off the weekly chart in late 1998. It became the leading winner of 1999, advancing 20-fold.)

When I met Tandy in his office in downtown Fort Worth, Texas, my reaction was very positive. He was a brilliant financial man who also happened to be an outstanding salesman. He had innovative incentives, departmental

financial statements, and highly detailed daily computer reports on sales of every item in every store by merchandise type, price, and category. His automated inventory and financial controls were almost unbelievable for that time.

After the stock tripled, Wall Street analysts started to acknowledge its existence. There were even a few research reports noting Tandy as an undervalued situation. Isn't it strange how far some stocks have to go up before they begin to look cheap to everyone?

The Size Problem in Portfolio Management

Many institutions think size is a problem. Because they manage billions of dollars, there never seem to be enough big-capitalization stocks they can buy.

Let's face it: size is definitely an obstacle. It's easier to manage \$10 million than \$100 million; it's easier to manage \$100 million than \$1 billion; and \$1 billion is a piece of cake compared to running \$20 billion or \$30 billion. The size handicap simply means it's harder to buy or get rid of a huge stock holding in a small- or medium-sized company.

However, I believe it's a mistake for institutions to restrict their investments solely to large-cap companies. In the first place, there definitely aren't enough outstanding ones to invest in at any given time. Why buy a slow-performing stock just because you can easily acquire a lot of it? Why buy big-caps with earnings growing only 10% to 12% a year?

From 1981 to 1987, in the Reagan years, more than 3,000 dynamic, up-and-coming companies incorporated or had initial public offerings. This was a first, and was due mainly to several cuts in the capital gains tax during the early 1980s. Many small- to mid-sized entrepreneurial concerns became enormous market leaders that drove the unprecedented technology boom and expansion of new jobs in the 1980s and 1990s. Most were small, unknown companies, but you'll recognize them now as some of the greatest winning companies of that period. Here is a partial list of the thousands of ingenious innovators that reignited growth in America until the March 2000 market top.

Adobe Systems, Altera, America Online, American Power Conversion, Amgen, Charles Schwab, Cisco Systems, Clear Channel Communications, Compaq Computer, Comverse Technology, Costco, Dell Computer, Digital Switch, EMC, Emulex, Franklin Resources, Home Depot, International Game Technology, Linear Technology, Maxim Integrated Products, Micron Technology, Microsoft, Novell, Novellus Systems, Oracle, PeopleSoft, PMC-Sierra, Qualcomm, Sun Microsystems, UnitedHealth Group, US Healthcare, Veritas Computer, Vitesse Semiconductor, Xilinx.

As mentioned earlier, our government should lower the capital gains tax again and shorten the holding period to six months to help fuel a new cycle of entrepreneurial start-up companies and jobs.

Today's markets are more liquid than past markets, with volume of many medium-sized stocks averaging 500,000 to 5,000,000 shares a day. In addition, significant block crossing between institutions also aids liquidity. The institutional manager handling billions of dollars would be best advised to broaden his prospects to the 4,000 or more innovative companies available. This is better than restricting activities to the same few hundred large, well-known, or legal-list-type companies. And today, a huge number of international entrepreneurial stocks are available.

A sizable institution would probably be better off owning 500 companies of all sizes than 100 large, mature, slow-moving companies. Pension funds can address size problems of their own by spreading their money among several different managers with different investment styles. However, size isn't the number one problem for institutional investors. Frequently, it's their investment philosophies and methods that keep them from fully capitalizing on the potential of the market. Superior performance comes from fresh ideas, not from the same old overused, stale names or last cycle's favorites. For example, the super tech leaders of 1998 and 1999 will probably be replaced by many new consumer leaders in the twenty-first century.

Bottom Buyers' Bliss

Many institutions buy stocks on the way down, but bottom fishing isn't always the best way to achieve superior performance. It can place decision makers in the position of buying stocks slowly deteriorating or whose growth is decelerating.

Other money management groups use valuation models that restrict investments to stocks in the lower end of their historical P/E ranges. This approach works for a number of unusually capable, conservative professionals, but over time, it rarely produces superior results. Several major Midwest banks that use this approach have lagged in performance.

Too many analysts have a P/E hang-up. They want to sell a stock with a P/E that's up and buy one if its P/E is down. Fifty years of models of the most successful stocks show low or "reasonable" P/Es do not cause huge increases in price. Those who buy low P/Es probably missed every big stock market winner of the last half century.

Most of those who concentrate on the undervalued theory of stock selection may lag today's better managers. Sometimes these undervalued situations get more undervalued or lag the market for a long time. In the market

free-fall in late 2008 and early 2009, I noticed several value funds that were down about as much as some of the growth funds, which is unusual.

Comparing Growth versus Value Results

Over the previous 12 business cycles, it's been my experience the best money managers during a cycle produced average annual compounded total returns of 25% to, in a few rare cases, 30%. This small group consisted of either growth-stock managers or managers whose most successful investments were in growth stocks plus a few turnaround situations.

The best undervalued-type managers in the same period averaged only 15% to 20%. A few had gains of over 20%. Most typical investors haven't prepared themselves enough to average 25% or more per year, regardless of the method used.

Value funds will do better in down or poor market periods. Their stocks typically haven't gone up a large amount during the prior bull market periods, and so they will correct less. Therefore, people who want to prove the value case will pick a market top as the beginning point of a 10-year period to compare value with growth investing. This is an unfair comparison in which value investing may "prove" more successful than growth-stock investing. The reality is if you look at the situation fairly, growth-stock investing usually outperforms value investing over most periods. I am also not convinced over- and under-weighting relative to the S&P 500 Index is as wise as some managers believe.

Weaknesses of the Industry Analyst System

Another widely used expensive and ineffective practice is to hire a large number of analysts and divvy up coverage by industry.

The typical securities research department has an auto analyst, an electronics analyst, an oil analyst, a retail analyst, a drug analyst, and on and on. But this setup is not efficient and tends to perpetuate mediocre performance. What does an analyst who is assigned two or three out-of-favor groups do? Recommend the least bad of all the poor stocks she follows?

On the other hand, the analyst who happens to follow the year's best-performing group may recommend only two or three winners, missing many others. When the oil stocks boomed in 1979 and 1980, all of them doubled or tripled. The best shot up five times or more.

The theory behind dividing up research is to allow them to be an expert on an industry. In fact, Wall Street firms may hire a chemist from a chemical company to be their chemical analyst and a Detroit auto specialist to be

their auto analyst. These individuals may know the nuts and bolts of their industries, but in many cases, have little understanding of the general market and what makes leading stocks go up and down. Maybe this explains why virtually every analyst appearing on CNBC after September 2000 continued to recommend buying high-tech stocks on their way to 80% to 90% declines. People lost a lot of money if they followed this free advice on TV. A similar repeat performance occurred in 2008, when some fundamental analysts recommended buying oils and banks on their way down since they looked cheap. They then got a lot cheaper. An analyst's job should be to make money for clients.

Firms like to advertise they have more analysts, the largest department, or more top-ranked "all-star" analysts. I'd rather have five good analysts who are generalists than 60 or 70 who are confined to limited specialties. What are your chances of finding 60 or more analysts who are outstanding at making money in the market or finding moneymaking ideas?

The shortcomings of Wall Street analysts were never made plainer to investors than during the 2000 bear market. While the market continued to sell off and become the worst bear market since 1929, and former high-flying tech and Internet stocks were being decimated, Wall Street analysts continued to issue "buy" or "strong buy" recommendations on these stocks.

In October 2000, one major Wall Street firm ran full-page ads calling the market "One of the Ten Best Times to Own Stocks" in history. As we now know, the market continued to plummet well into 2001 and 2002, making that period one of the *worst* times in history to own stocks! It was not until many of the tech and Internet high-flyers were down 90% or more from their peaks that these analysts finally changed their tune—many days and many dollars late!

A December 31, 2000, *New York Times* article on analysts' recommendations quoted Zacks Investment Research as follows: "Of the 8,000 recommendations made by analysts covering companies in the Standard & Poor's 500 Index, only 29 now are sells." In the same article, Arthur Levitt, chairman of the Securities and Exchange Commission, stated: "The competition for investing banking business is so keen that analysts' sell recommendations on stocks of banking clients are very rare." A mutual fund manager quoted by the *Times* said: "What passes for research on Wall Street today is shocking to me. Instead of providing investors with the kind of analysis that would have kept them from marching over the cliff, analysts prodded them forward by inventing new valuation criteria for stocks that had no basis in reality and no standards of good practice." *Vanity Fair* also ran an interesting article on the analytical community in August 2001. Clearly, at no time in the history of the markets has the

phrase *caveat emptor* had more meaning for investors, both institutional and individual alike.

The implementation of SEC Rule FD, governing fair disclosure of material company information to both institutional and individual investors, in 2000 has restricted the ability of major brokerage research analysts to receive inside information from a company before it is released to the rest of the Street. This further reduced any advantage that can be gained by listening to most Wall Street analysts. We prefer to deal only with facts and historical models rather than opinions about supposed values. Many research analysts in 2000 and 2001 had not been in the business for 10 years or longer and therefore had never experienced the terrible bear markets of 1987, 1974–1975, and 1962.

On still another subject, many large money-management groups probably deal with entirely too many research firms. For one thing, there aren't that many strong research inputs, and dealing with 20 or 30 firms dilutes the value and impact of the few good ones. Confusion, doubt, and fear created by conflicting advice at critical junctures may prove to be expensive. It would be interesting to know how many analysts have been highly successful in their own investments. This is the ultimate test.

Financial World's Startling Survey of Top Analysts

A *Financial World* article dated November 1, 1980, also found that analysts selected by *Institutional Investor* magazine as the best on Wall Street were overrated and overpaid, and they materially underperformed the S&P averages. As a group, the “superstar” analysts failed on two out of three stock picks to match either the market or their own industry averages. They also seldom provided sell recommendations, limiting most of their advice to buys or holds. The *Financial World* study confirmed research we performed in the early 1970s. We found only a minority of Wall Street recommendations were successful. We also concluded during a period where many sell opinions were in order, just 1 in 10 reports made a sell suggestion.

Database Power and Efficiency

On any day, most institutional money managers receive a stack of research reports. Trudging through them in search of a good stock is usually a waste of time. If lucky, they may spot 1 in 20 that's right to buy.

In contrast, managers with access to WONDA can rapidly screen all the companies in our database. If the defense industry pops up as one of the leading industries, they can call up 84 different companies whose pri-

mary business is in that area. The typical institution might look at Boeing, Raytheon, United Technologies, and two or three other big, well-known names. Since WONDA provides more than 3,000 technical and fundamental variables on each of the 84 companies stretching back a number of years, as well as the ability to display these variables quickly on identical graphic displays, it's possible for an institutional money manager to identify in 20 minutes the 3 or 4 companies in the entire group that show outstanding characteristics and are worthy of more detailed research. It's a vital time-saver some of America's very best money managers relentlessly use.

In other words, there are ways for an institution's analysts to spend their time far more productively. Yet, not all research departments are organized to take advantage of such advanced and disciplined procedures.

How well has this approach worked? In 1977, we introduced an institutional service called New Stock Market Ideas and Past Leaders to Avoid (NSMI). Now titled New Leaders and Laggards Review, it is published every week, and its documented, 31-year long-term performance record is shown on the accompanying graph. These performance returns were audited and verified by one of the top independent accounting firms in America.

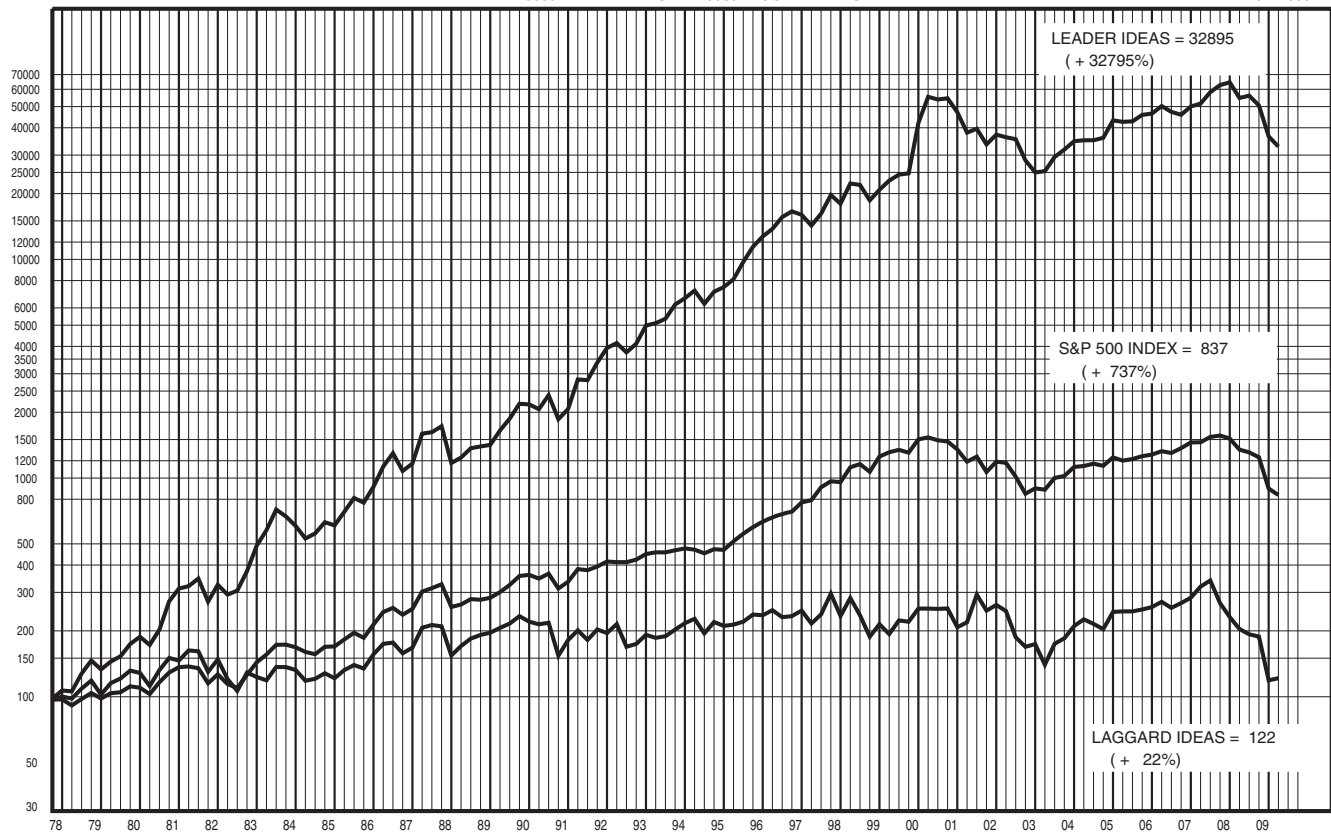
Over the last 30 years, positive selections outperformed *avoids* 307 to 1, and positive picks outran the S&P 500 stocks more than 41-fold. Compounding over the 30 years' time helps make a superior long-term record like this possible. For the entire 30 years ended 2008, stocks to avoid made a teeny 19% gain. Institutions could have improved their performance just by staying out of the stocks on our avoid list. As a service to our institutional clients, we provide them with computerized quarterly performance reports for every *positive* and *avoid* suggestion made in the New Leader Ideas service. How many competing firms provide the actual percent performance of all of their ideas over an extended period?

By having massive factual data on every firm and proven historical precedent chart models over more than 100 years, we're able to discover a stock beginning to improve or get in trouble earlier—without ever visiting or talking to the company. It may be naïve to believe companies are always going to tell you when they are beginning to have problems. By using our own factual data and historical precedent research, we discourage reliance on tips, rumors, and analysts' personal opinions. We don't need such information. We also do not have investment banking clients or market-making activities. Nor do we manage money for other people or hire research analysts to prepare long written research reports. So those areas of potential bias or underperformance are nonexistent.

O'NEIL NEW LEADERS & LAGGARDS REVIEW 31-YEAR LONG-TERM RECORD

10635 LEADER IDEAS AND 5089 LAGGARD IDEAS

MARCH 2009



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Performance computations reflect a weekly compounded rate of return. Dividends and commissions were not considered in any computations. All holdings are rebalanced to equal dollar amounts at the beginning of the week. Percent gains and losses are calculated for all issues that remain on the "LEADER IDEAS" or "LAGGARD IDEAS" at the end of the week.

Performance results do not represent actual trading, and they may not reflect the impact that material economic and market factors might have had on the investment decision-making process if actually managing client money. The above does not imply comparable future performance. It should be recognized there is substantial speculative risk in most common stocks.

The 1982 and 1978 Full-Page Bullish Ads

We don't try to call every short-term or intermediate correction. Our primary focus is on recognizing and acting upon the early stages of each new bull or bear market. This includes searching for market sectors and groups that should be bought and those that should be avoided.

In early 1982, we placed a full-page ad in the *Wall Street Journal* stating the back of inflation had been broken and the important stocks had already made their lows. That May, we mailed out two wall charts to our institutional clients: one of defense electronics stocks, and the other of 20 consumer growth stocks we thought might be attractive for the bull market ahead. We also made a point of going to New York and Chicago to meet with several large institutions. In these meetings, we stated our bullish posture and provided a list of names that could be purchased after these organizations did their due diligence.

The stance we took was counter to the position of most institutional research firms at that time, as well as to the negative news flooding out of the national media each day. Most investment firms were downright bearish. They anticipated another big down leg in the market. They also projected interest rates and inflation would soar back to new highs as a result of government borrowing that would crowd the private sector out of the marketplace.

The fear and confusion created by these judgments frightened many large investors. As a result, they did not fully capitalize on the fact that we had identified two leading groups for the coming bull market. It appeared professional managers had been bombarded with so much negative "expert" Wall Street input that they found positive findings hard to believe. As for us, we invested fully in the summer of 1982 and enjoyed our best performance up to that time. From 1978 to 1991, our account increased 20-fold. From the beginning of 1998 through 2000, our firm's account, run out of our separate holding company, increased 1,500%. Results such as this remind us it may be an advantage *not* to be headquartered in rumor-filled and emotion-packed Wall Street. I have never worked one day on Wall Street in my entire time in the investment field.

As a savvy individual investor, you have a gigantic advantage in not having to listen to different, strongly held opinions. You can see from this example that majority opinions seldom work in the market and that stocks seem to require doubt and disbelief—the proverbial "wall of worry"—to make meaningful progress. The market contrarily moves to disappoint the majority.

Our first full-page *Wall Street Journal* ad was in March 1978. It predicted a new bull market in small- to mid-sized growth stocks. We had written the "Grab The Bull By The Horns" ad weeks ahead of time and waited to run it

until the time was right. The right time came when the market was making new lows, which caught investors by surprise. Our only reason for placing the ad was to document in print what our position was at that point, so institutional investors could have no question about it later. We were also one of the few firms to tell its accounts they should avoid or sell tech stocks and raise cash in March, April, and September 2000.

It is at these extremely difficult market turning points an institutional firm can be of most value. At such times, many people are either petrified with fear or carried away with excessive fundamental information.

Institutional Investors Are Human

If you don't think fear and emotion can ride high among professional investors after a prolonged decline, think again. I remember meeting with the top three or four money managers of one important bank at the bottom of the 1974 market. They were as shell-shocked, demoralized, and confused as anyone could possibly be. (The ordinary stock at that time was down 75%.) About the same time, I recall visiting another top manager. He too was thoroughly worn out and, judging from the peculiar color of his face, suffering from market sickness. Yet another top fund manager in Boston looked as if he'd been run over by a train. (Of course, all of this is preferable to 1929, when some people jumped out of office buildings in response to the devastating market collapse.)

I also recall a high-tech seminar in 1983 in San Francisco, attended by 2,000 highly educated analysts and portfolio managers. Everyone was there, and everyone was ebullient and self-confident. That marked the exact top for high-tech stocks.

I also remember a presentation we gave to a bank in another large city. All its analysts were brought in and sat around an impressive table in the boardroom, but not one analyst or portfolio manager asked any questions during or after the presentation. It was the strangest situation I've ever been in. Needless to say, this institution consistently performed in the lower quartiles compared to its more alert and venturesome competitors. It's important to communicate and be open to new ideas.

Years ago, one medium-sized bank for which we did consulting work insisted we give them recommendations only from among the stocks it carried on its limited approved list. After consulting with the bank's managers each month for three months and telling them there was nothing on their approved list that met our qualifications, we had to honorably part company. A few months later, we learned key officials in that trust department had been relieved of their jobs as a result of their laggard performance.

We provided product to another Midwest institution, but it was of doubtful value because the institution had a cast-in-concrete belief that any potential investment had to be screened to see if it passed an undervalued model. The best investments rarely show up on any undervalued model, and there's probably no way this institution will produce first-rate results until it throws out the model. This isn't easy for large organizations to do. It's like asking a Baptist to become a Catholic or vice versa.

Some large money-management companies with average records tend to fire the head of the investment department and then look for a replacement who invests pretty much the same way. Naturally, this doesn't solve the problem of deficient investment methods. Security Pacific Bank in Los Angeles was an exception to this rule. In July 1981, it made a change in its top investment management. It brought in an individual with a completely different approach, a superior investment philosophy, and an outstanding performance record. The results were dramatic and were accomplished almost overnight. In 1982, Security Pacific's Fund G was ranked number one in the country.

Penny-Wise and Performance-Foolish

Some corporations put too much emphasis on saving management fees, particularly when they have giant funds to be managed. It's usually an actuary who convinces them of the money their pension fund can save by shaving the fee by $\frac{1}{4}$ of 1%.

If corporations have billions of dollars to be managed, it makes sense for them to increase their fees and incentives so they can hire the best money managers in the business. The better managers will earn the extra 0.25% or 0.50% ten times over. The last thing you ever want is cheap advice in the stock market. If you were going to have open-heart surgery, would you look for the doctor who'll charge the absolute least?

How to Select and Measure Money Managers

Here are a few tips for organizations that want to farm out their funds to several money managers.

In general, portfolio managers should be given a complete cycle before their performance is reviewed for the purpose of deciding whether to change managers. Give them from the peak of one bull market period to the peak of the next or from the trough of one cycle to the trough of another. This will usually cover a three- or four-year period and allow all managers to go through both an up market and a down market. At the end

of this period, the bottom 20% of managers in performance should be replaced. Thereafter, every year or two, the bottom 5% or 10% over the most recent three- or four-year period should be dropped. This avoids hasty decisions based on disappointing performance over a few short quarters or a year. Given time, this process will lead to an outstanding group of proven money managers. Because this is a sound, longer-term, self-correcting system, it should stay that way. Then it won't be necessary to pay as many consultants to recommend changes in personnel.

In selection of managers, consideration should be given to their latest three- to five-year performance statistics as well as to a more recent period. Diversification among the types, styles, and locations of managers should be considered. The search should be widespread and not necessarily limited to one consultant's narrow, captive universe or stable of managers.

The corporate or pension fund client with money to be managed also has to be careful not to interfere at critical junctures—deciding, for example, when a greater proportion of the portfolios should be either in stocks or in bonds or that undervalued stocks should be emphasized.

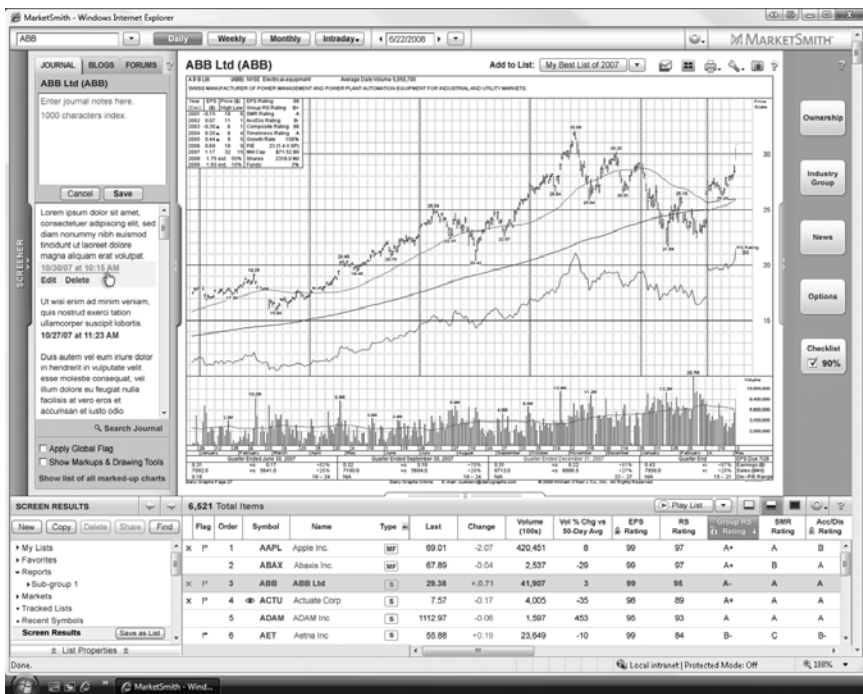
Cities and counties that have funds to invest must be extremely careful. Few of their personnel are highly experienced in the investment field. These inexperienced people can easily be talked into investing in bonds that are promoted as being safe but that later cause enormous losses. This happened, of course, in 2008 with AAA subprime loans in real estate mortgage packages.

Clients can also interfere by directing where commissions should go or insisting that executions be given to whomever does them most cheaply. The latter, while a well-meaning attempt to save money, commonly results in forcing upon a money manager someone who provides either poorer executions or no research input of real value. This handicap costs the portfolio money, as it pays $\frac{1}{2}$ point or more (or its decimal equivalents) on trades that are executed by less expert people.

Daily Graphs Online becomes MarketSmith®

In 1973, a friend suggested that we produce a weekly chart book to help retail investors find growth stocks with CAN SLIM characteristics. Our weekly Daily Graphs® books were a tremendous success because they helped investors cull through thousands of potential investments quickly and efficiently. We still print them, but in 1998 Daily Graphs moved online with applications such as Charting, Custom Screens, Industry Groups, Option Guide, and Mutual Fund Center.

In early 2010, Daily Graphs Online will again transform itself into MarketSmith. MarketSmith graphs stay true to the original Daily Graphs



design. But we've taken the tool a few steps beyond the expected. We engaged one of the country's premier Web site design firms to help us create a research tool that was robust enough for the sophisticated user and yet intuitive enough for the novice investor.

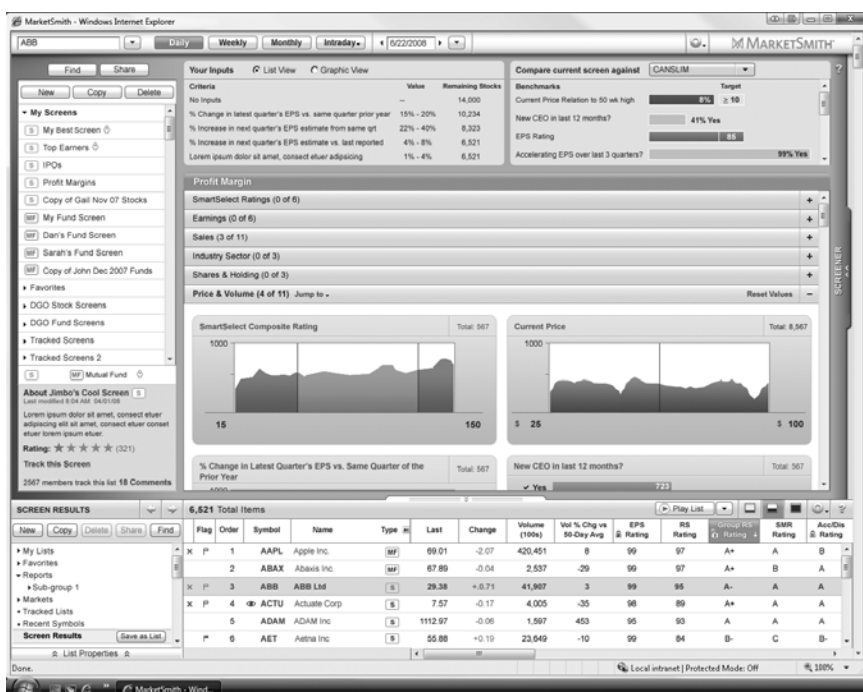
MarketSmith gives users access to several proprietary ratings and rankings such as Relative Strength Rank, Earning Per Share Rank, Sales-Margins-Return on Equity (SMR) Rating, and the Composite Rating using the same institutional quality data that William O'Neil + Company provides to professional money managers through the WONDA platform.

We've integrated a checklist feature to help remind an investor how any stock rates against important financial benchmarks.

MarketSmith has a visually intuitive stock and mutual fund database screening module. Investors can search over 7,000 stocks and 9,000 mutual funds to find those that meet specific fundamental and technical criteria.

MarketSmith users who belong to investment clubs or attend IBD Meet-ups can share database screens and stock lists and blog about their own market observations and experiences. IBD subscribers have exclusive access to IBD content such as the IBD news stories and the IBD 100.

We've designed MarketSmith so it can run on a Mac or PC, and there's even a MarketSmith iPhone application for when you are away from your desk.



MarketSmith is the ultimate stock research tool that takes the information and knowledge that you gain from reading this book and brings it to life. As you gain experience and learn to effectively use MarketSmith, you can truly become an investing master.

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• CHAPTER •

Important Time-Tested Proven Rules and Guidelines to Remember

1. Don't buy cheap stocks. Buy mainly Nasdaq stocks selling at between \$15 and \$300 a share and NYSE stocks selling from \$20 to \$300 a share. The majority of super stocks emerge from sound strong chart bases of \$30 and up. Avoid the junk pile below \$10.
2. Buy growth stocks where each of the last three years' annual earnings per share have been up at least 25% and the next year's consensus earnings estimate is up 25% or more. Many growth stocks will also have annual cash flow of 20% or more above EPS.
3. Make sure the last two or three quarters' earnings per share are up a huge amount. Look for a minimum of 25% to 30%. In bull markets, look for EPS up 40% to 500%. (The higher, the better.)
4. See that each of the last three quarters' sales are accelerating in their percentage increases or the last quarter's sales are up at least 25%.
5. Buy stocks with a return on equity of 17% or more. The outstanding companies will show a return on equity of 25% to 50%.
6. Make sure the recent quarterly after-tax profit margins are improving and are near the stock's peak after-tax margins in prior quarters.
7. Most stocks should be in the top six or more broad industry sectors in IBD's daily "New Price Highs" list or in the top 10% of IBD's "197 Industry Sub-Group Rankings."

8. Don't buy a stock because of its dividend or its P/E ratio. Buy it because it's the number one company in its particular field in terms of earnings and sales growth, ROE, profit margins, and product superiority.
9. In bull markets, buy stocks with a Relative Price Strength rating of 85 or higher in *Investor's Business Daily's SmartSelect* ratings.
10. Any size capitalization will do, but the majority of your stocks should trade an average daily volume of several hundred thousand shares or more.
11. Learn to read charts and recognize proper bases and exact buy points. Use daily and weekly charts to materially improve your stock selection and timing. Long-term monthly charts can help, too. Buy stocks when they initially break out of sound and proper bases with volume for the day 50% or more above normal trading volume.
12. Carefully average up, not down, and cut every single loss when it is 7% or 8% below your *purchase price*, with absolutely no exceptions.
13. Write out your sell rules that determine when you will sell and nail down a worthwhile profit in your stock on the way up.
14. Make sure that one or two better-performing mutual funds have bought your stock in the last reporting period. You also want your stocks to have increasing institutional sponsorship over the last several quarters.
15. The company should have an excellent, new, superior product or service that is selling well. It should also have a big market for its product and the opportunity for repeat sales.
16. The general market should be in an uptrend and be favoring either small- or big-cap companies. (If you don't know how to interpret the general market indexes, read IBD's "The Big Picture" column every day.)
17. Don't mess around with options, stocks trading only in foreign markets, bonds, preferred stocks, or commodities. It doesn't pay to be a "jack-of-all-trades" or overdiversify or have too much asset allocation. Either avoid options outright or restrict them to 5% or 10% of your portfolio.
18. The stock should have ownership by top management.
19. Look mainly for "new America" entrepreneurial companies (those with a new issue within the last eight or even up to 15 years) rather than too many laggard, "old America" companies.
20. Forget your pride and your ego; the market doesn't care what you think or want. No matter how smart you think you are, the market is always smarter. A high IQ and a master's degree are no guarantee of market success. Your ego could cost you a lot of money. Don't argue with the market. Never try to prove you're right and the market is wrong.

21. Read *Investor's Corner* and "The Big Picture" in IBD daily. Learn how to recognize general market tops and bottoms. Read up on any company you own or plan to buy; learn and understand its story.
22. Watch for companies that have recently announced they are buying back 5% to 10% or more of their common stock. Find out if there is new management in the company and where it came from.
23. Don't try to buy a stock at the bottom or on the way down in price, and don't average down. (If you buy the stock at \$40, don't buy more if it goes down to \$35 or \$30.)

Key Reasons People Miss Buying Great Winning Stocks

1. Disbelief, fear, and lack of knowledge. Most big winners are newer companies (with IPOs in the last eight or 15 years). Everyone knows Sears and General Motors, but most people are simply unaware of or unfamiliar with the hundreds of new names that come into the market every year. The new America names are the great growth engine of America, creating innovative new products and services plus most of the new technology. (A chart service is one easy way to at least be aware of the basics of price, volume, sales, and earnings trends of all these compelling younger entrepreneurial companies.)
2. P/E bias. Contrary to conventional wisdom, the best stocks rarely sell at low P/Es. Just as the best ballplayers make the highest salaries, the better companies sell at better (higher) P/Es. Using P/Es as a selection criterion will prevent you from buying most of the best stocks.
3. Not understanding that the real leaders start their big moves by selling near or at new price highs, not near new lows or off a good amount from their highs. Investors like to buy stocks that look cheap because the stocks are lower than they were a few months ago, so they buy stocks on the way down. They think they are getting bargains. They should be buying stocks that are on the way up, just making new price highs as they emerge from a proper base or price consolidation area.
4. Selling too soon, either because they get shaken out or because they are too quick to take a profit, and psychologically having a hard time buying back a stock at a higher price if necessary. They also sell too late, letting a small loss turn into a devastating one by not cutting all their losses at 8%.

One Final Thought

You can definitely become financially independent once you learn to save and invest properly. But you first have to get serious and make up your mind to work at it and never let yourself get discouraged, regardless of circumstances. My parting advice: have courage, be positive, and don't ever give up. Great opportunities occur every year in America. Get yourself prepared, study, learn, and go for them. What you'll find is that little acorns can, over time, grow into giant oaks, and that with persistence and hard work, anything is possible. You can do it, and your own determination to succeed is the most important element. When you get off the track and make mistakes, which all of us do, re-read this book, attend a workshop or seminar, or take a home-study course and get back on track . . . there are no overnight successes in the stock market.

Success in a free country is simple.

Get a job, get an education, and learn to save and invest wisely.

Anyone can do it. You can do it.

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Test Your Knowledge

This bonus chapter will help you apply what you just learned in *How to Make Money in Stocks*. The material is a fun and interactive way to help you use some of the CAN SLIM rules right away to recognize the traits of winning stocks.

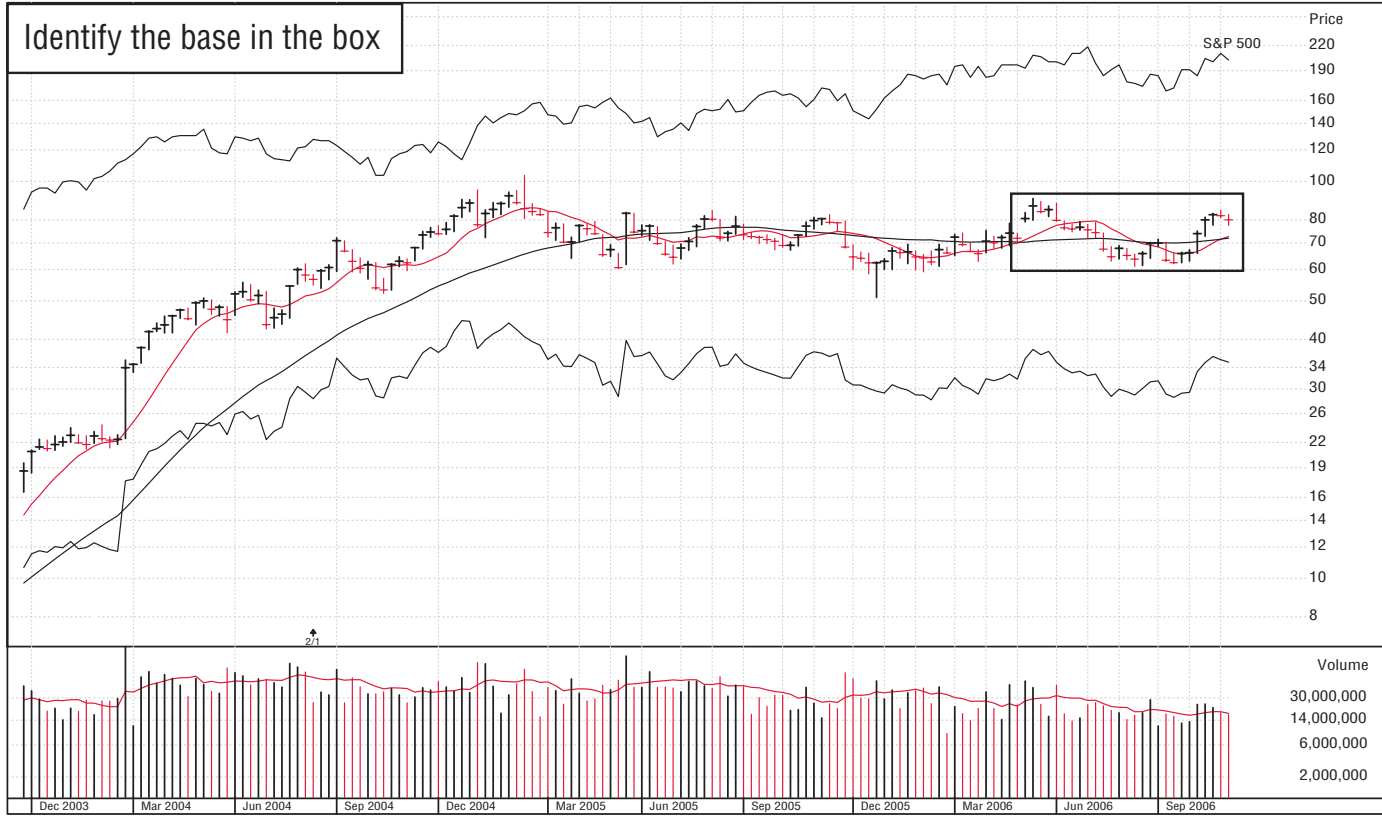
Although we will focus on charts in this chapter, remember that *what* to buy is determined mostly by fundamental analysis of such factors as earnings, sales, and return on equity. The charts will assist you in figuring out *when* to buy those fundamentally superior stocks. Selling decisions, however, are made mostly by looking at the charts. If you wait for the fundamentals to become poor, you will often sell late.

This bonus chapter has four main components to test your knowledge:

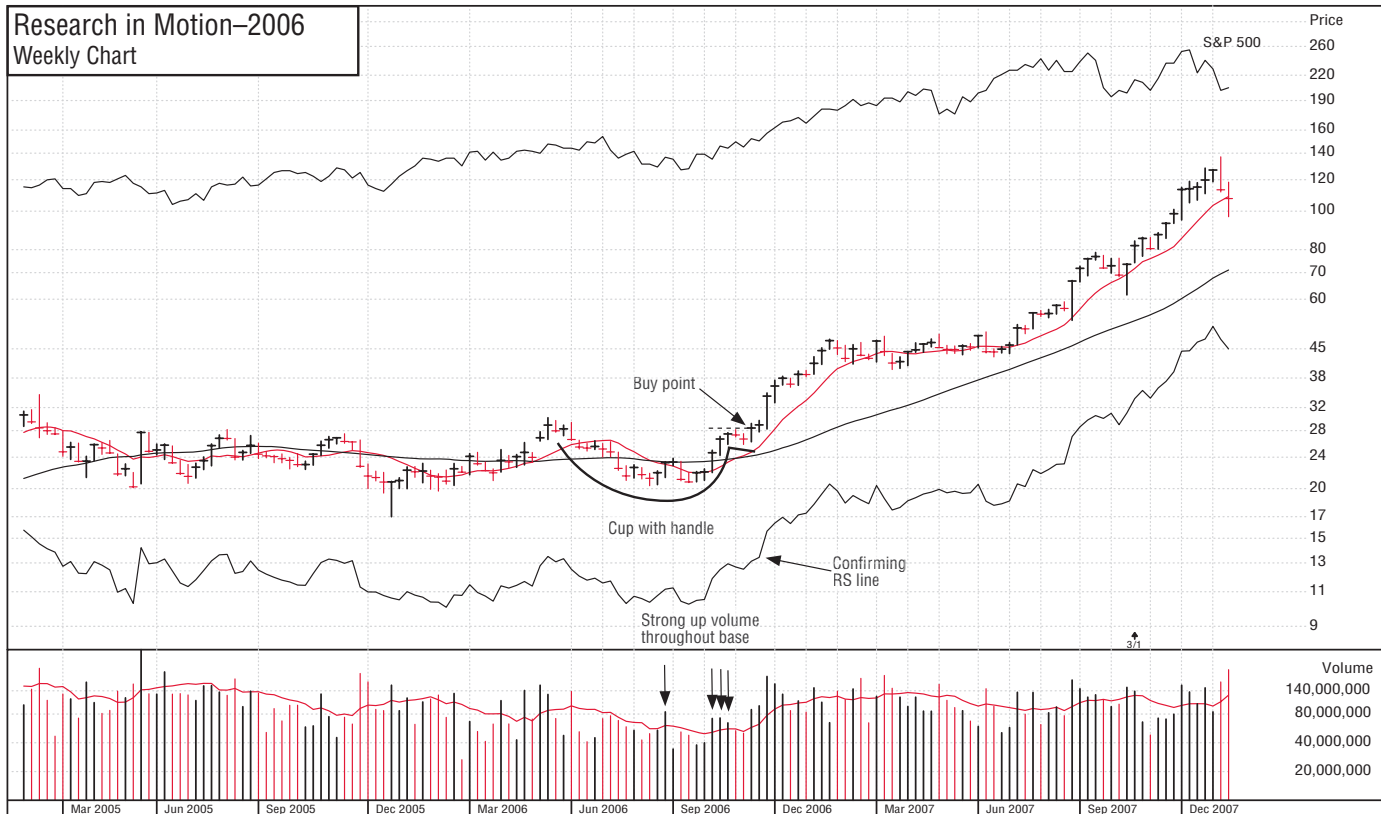
- *Find the Chart Base*. You'll be asked to identify a base in the boxed area of a chart and then you'll flip the page to see if you're right. This section covers the three most common chart patterns: cup with handle, double bottom and flat base.
- *Would You Buy?* You'll be shown a chart and be asked "Would you buy this stock?" Look for clues within the chart's price and volume changes as well as in the Relative Price Strength line. Decide yes or no, and then turn the page to get the answer.
- *Sell Signals*. You'll be asked to look for the sell signals that were discussed in the book and then you'll see the sell signals identified on the next page.
- *20 Questions*. This quiz will test your knowledge on several key areas of the CAN SLIM Investing System.

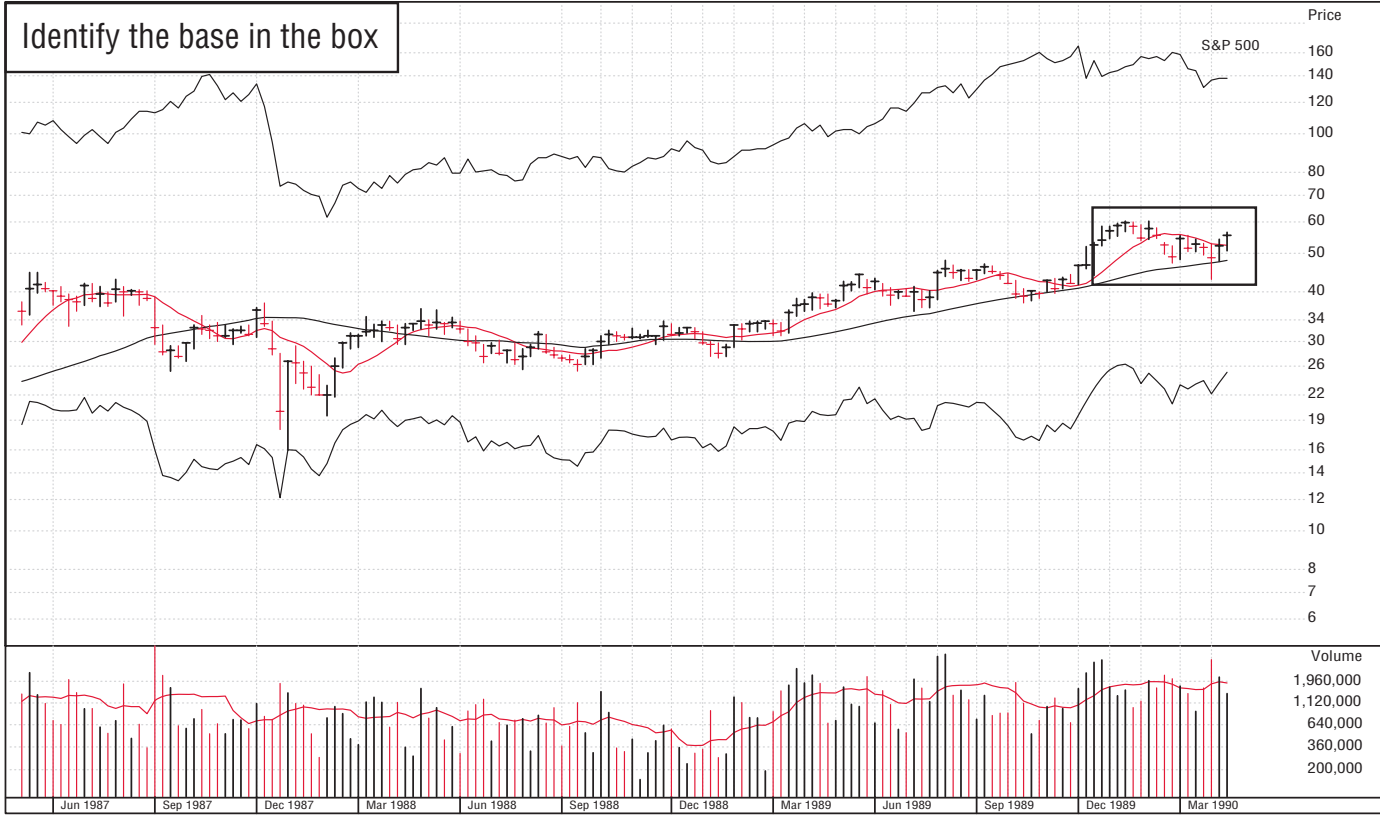
It's OK if you don't get everything right the first time. It takes a while to learn to read charts. The more charts you look at, the better you'll get at identifying those stocks that have the characteristics of a big winner. Plus, IBD offers many tools and educational opportunities to help you learn this key skill; we'll discuss these at the end of this chapter.

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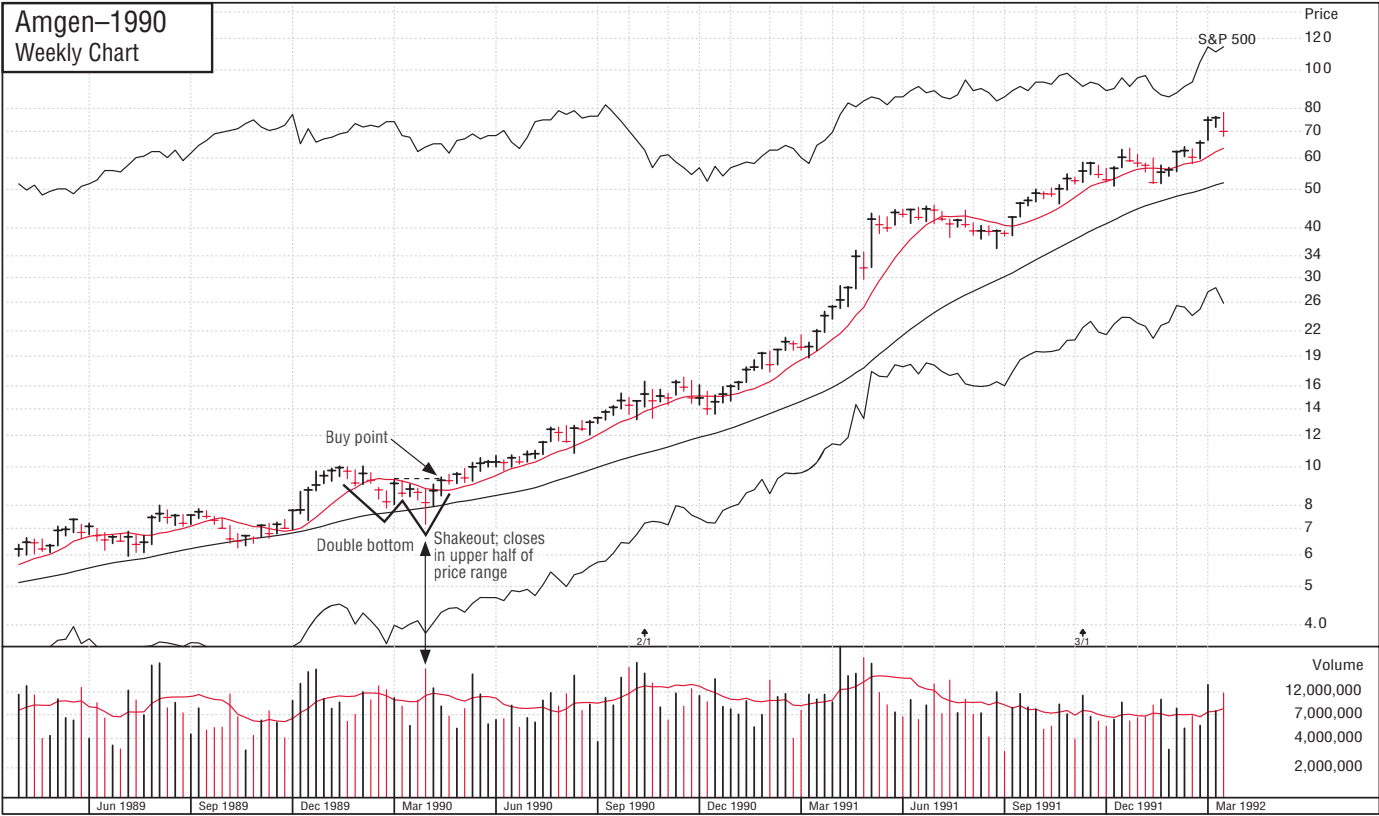


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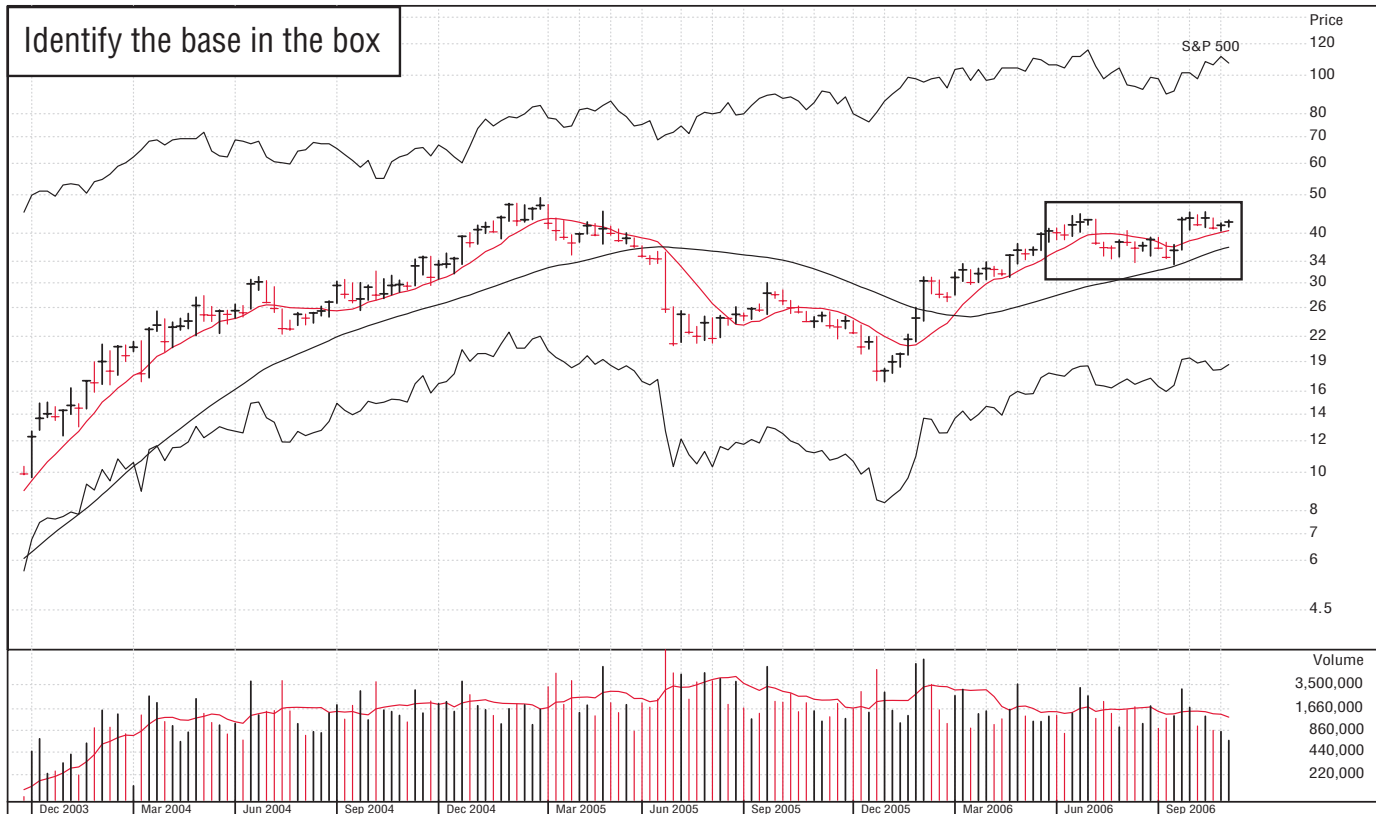




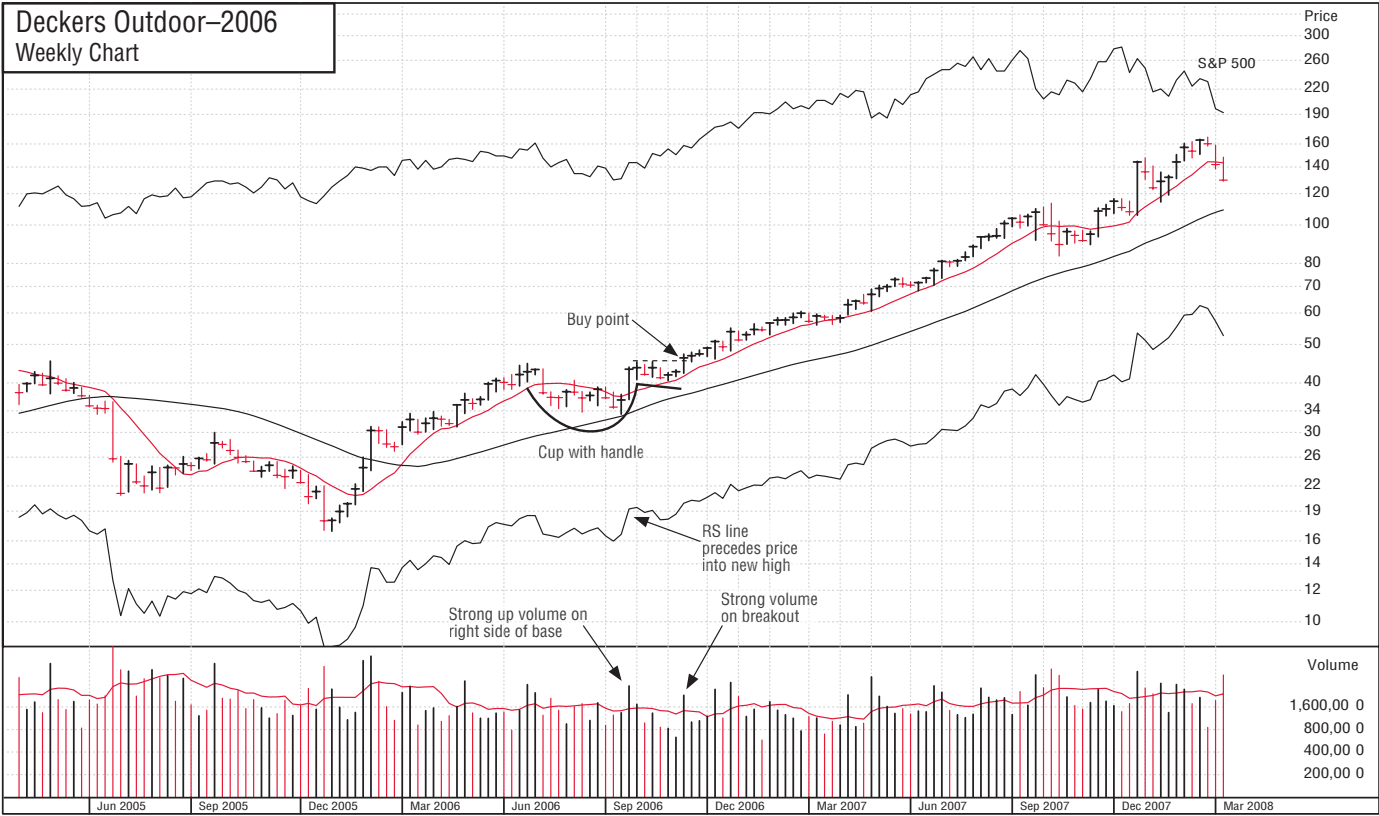
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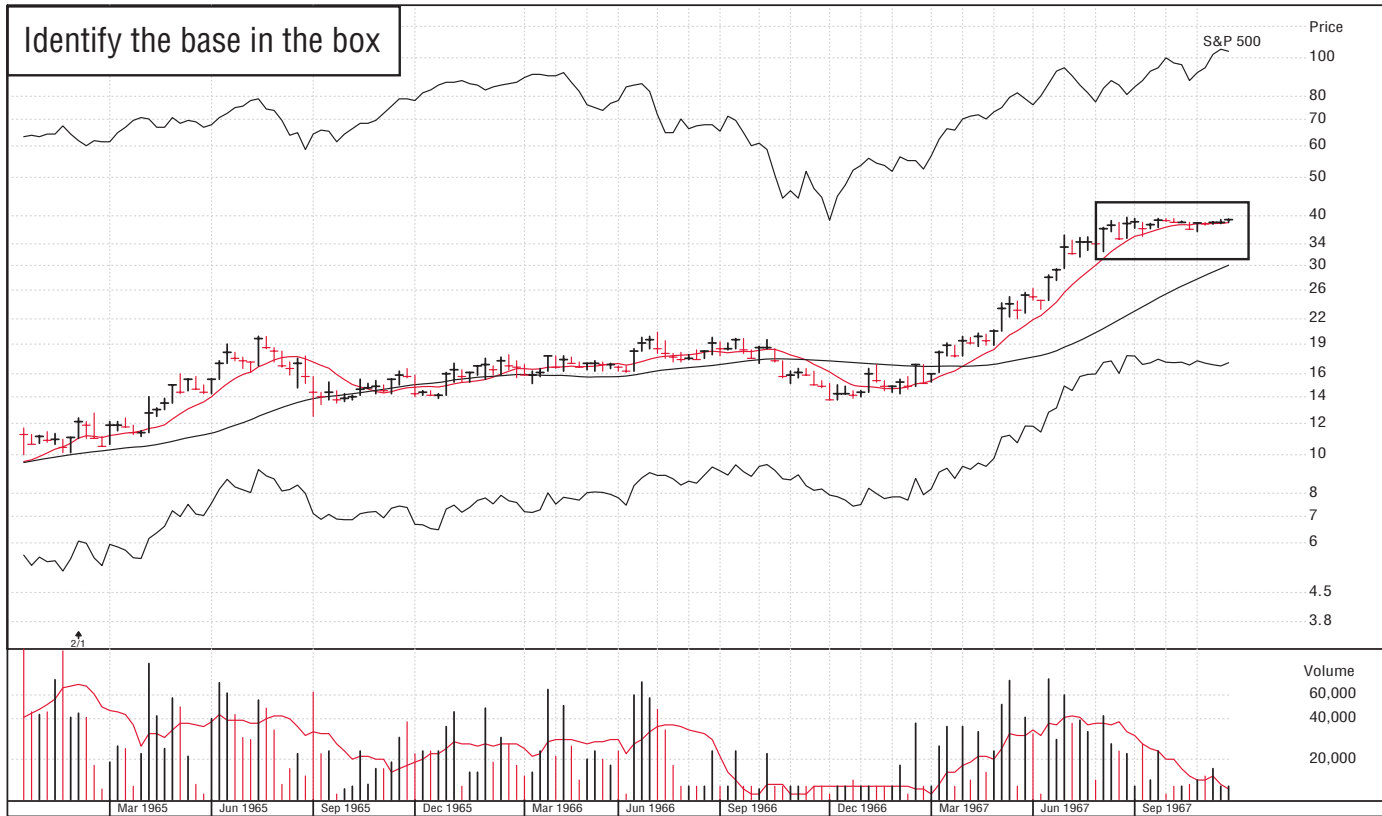


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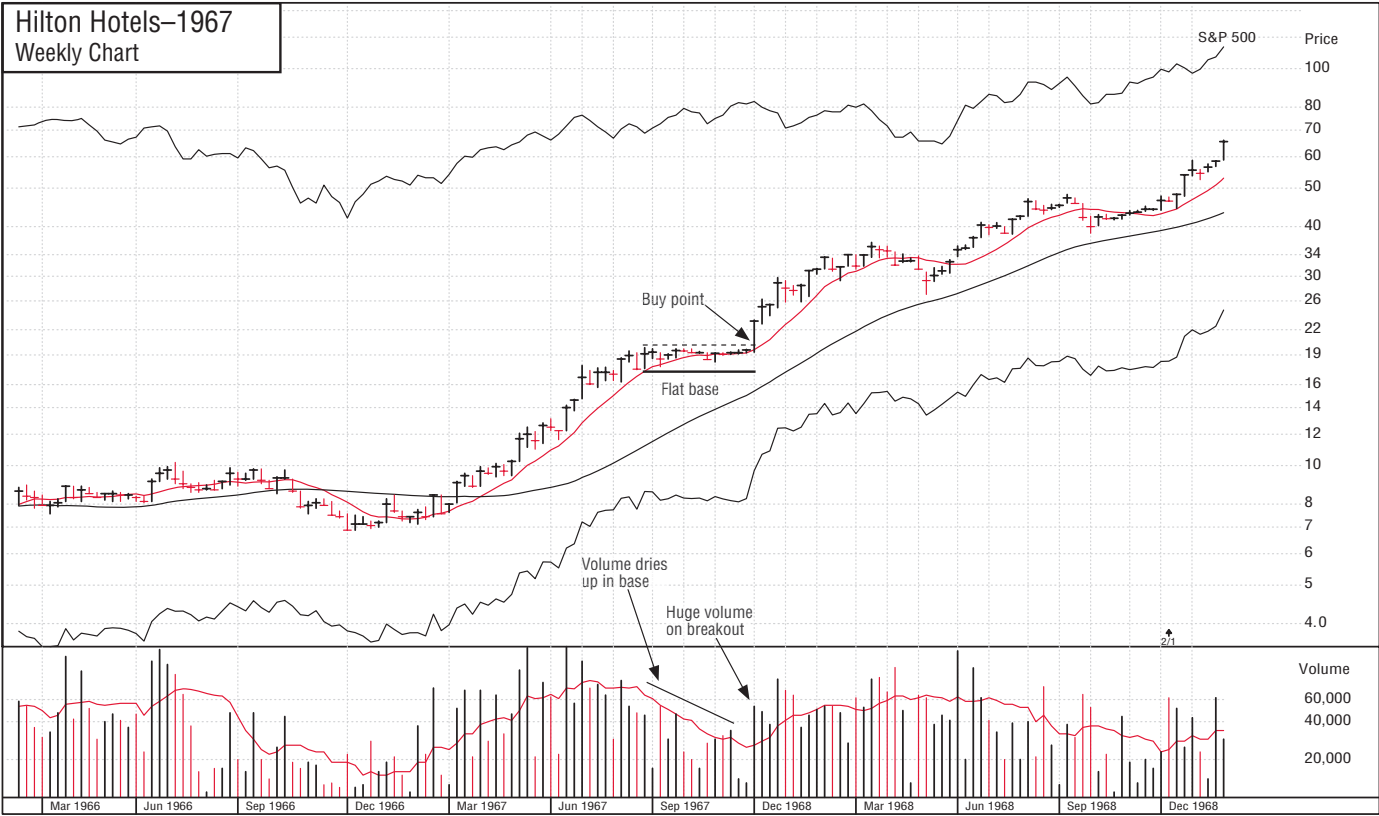


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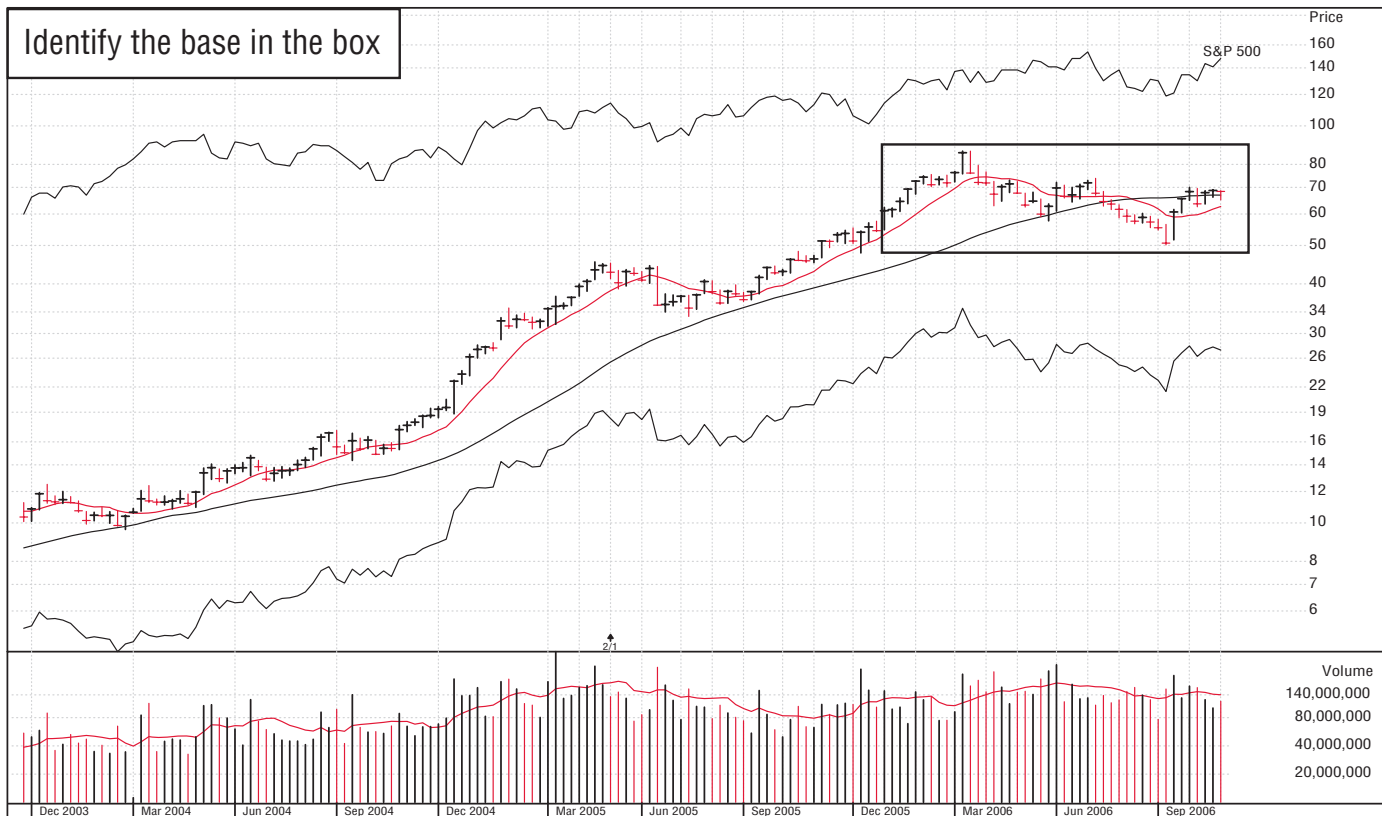




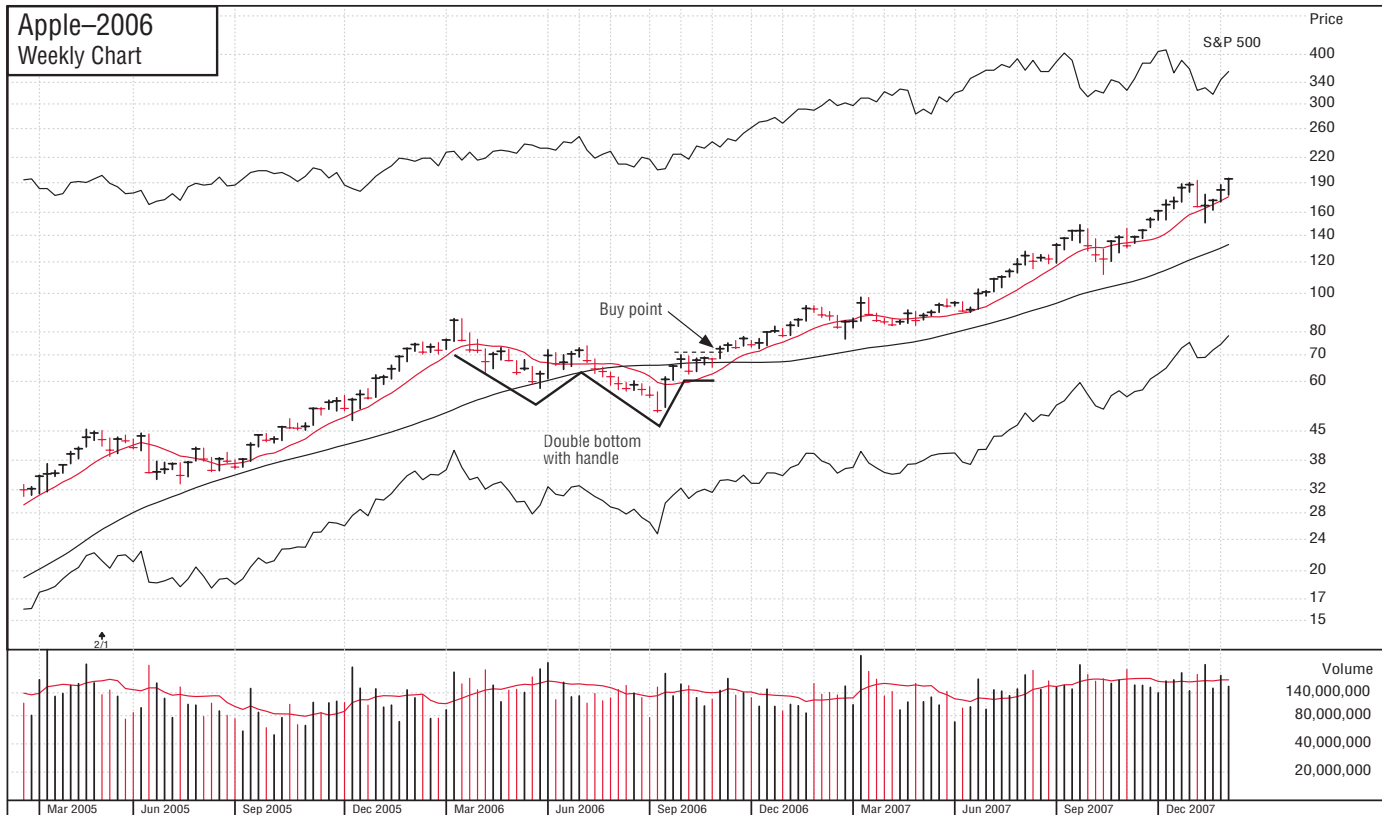
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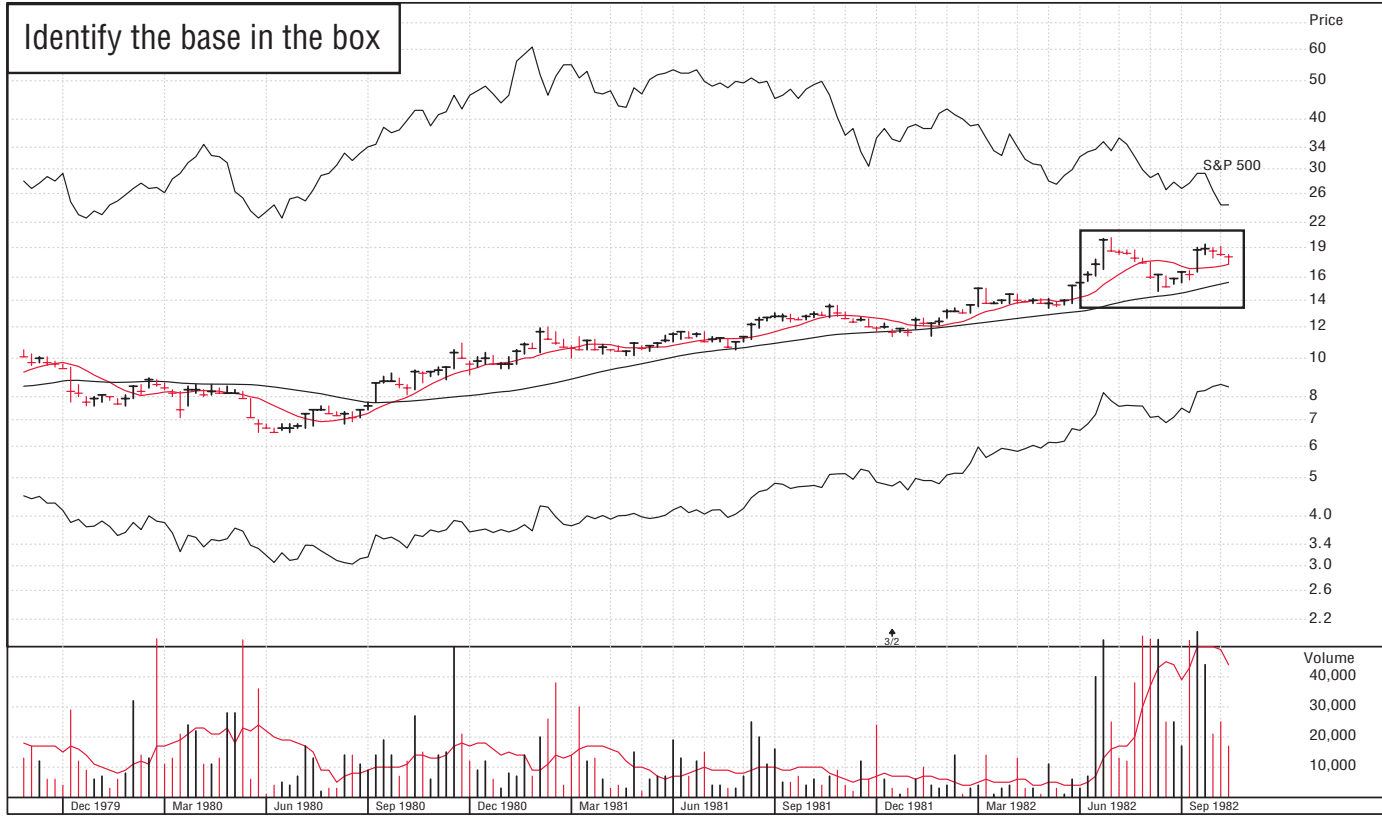


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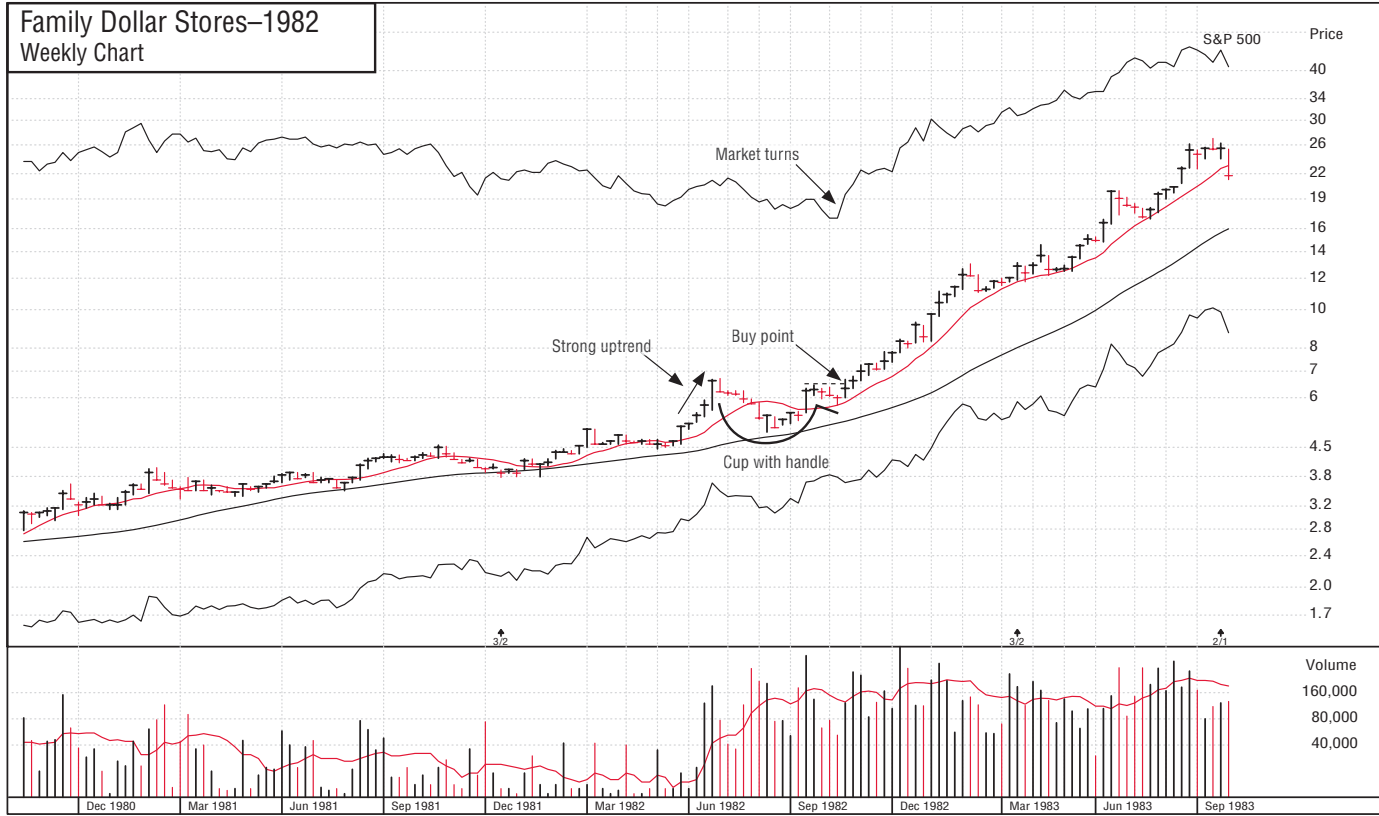


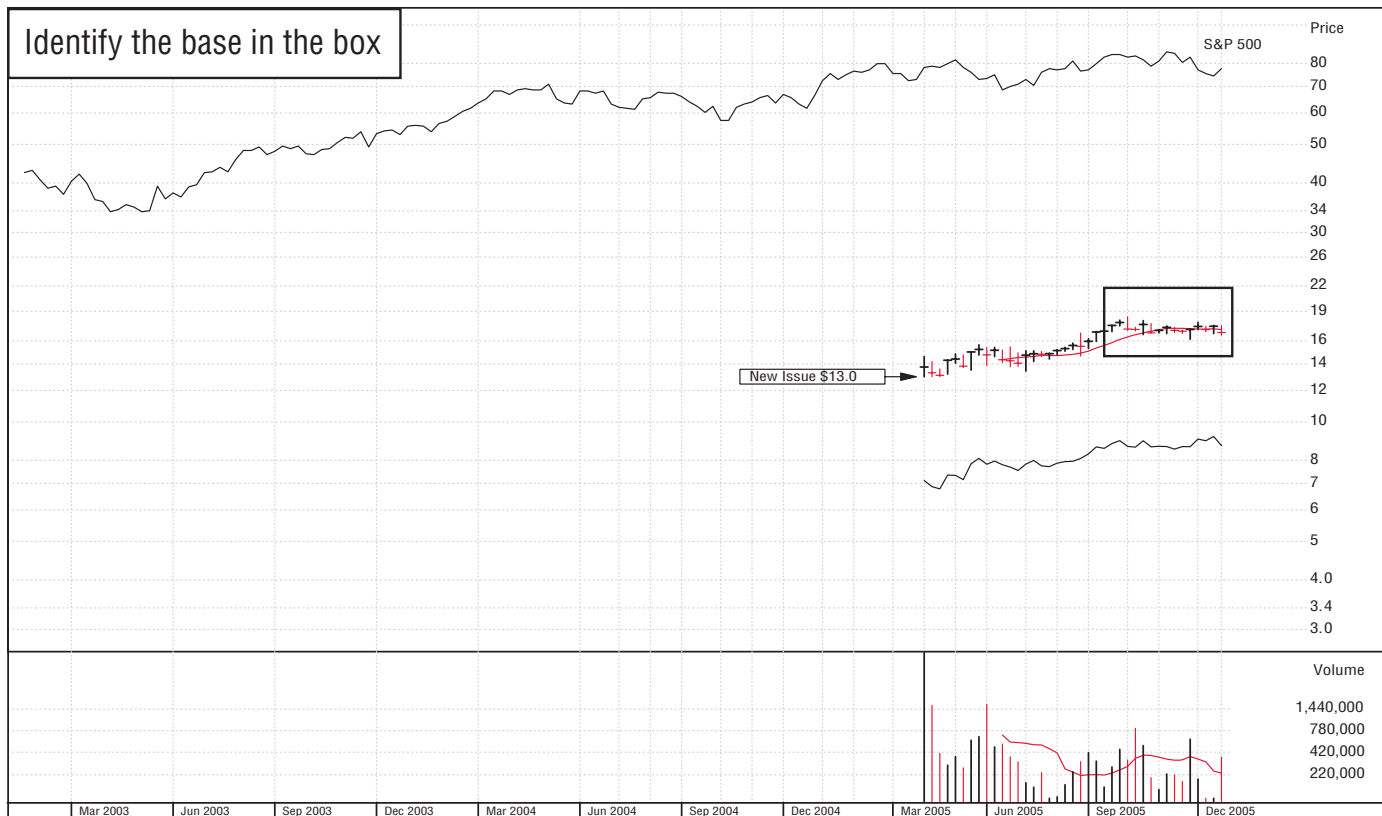
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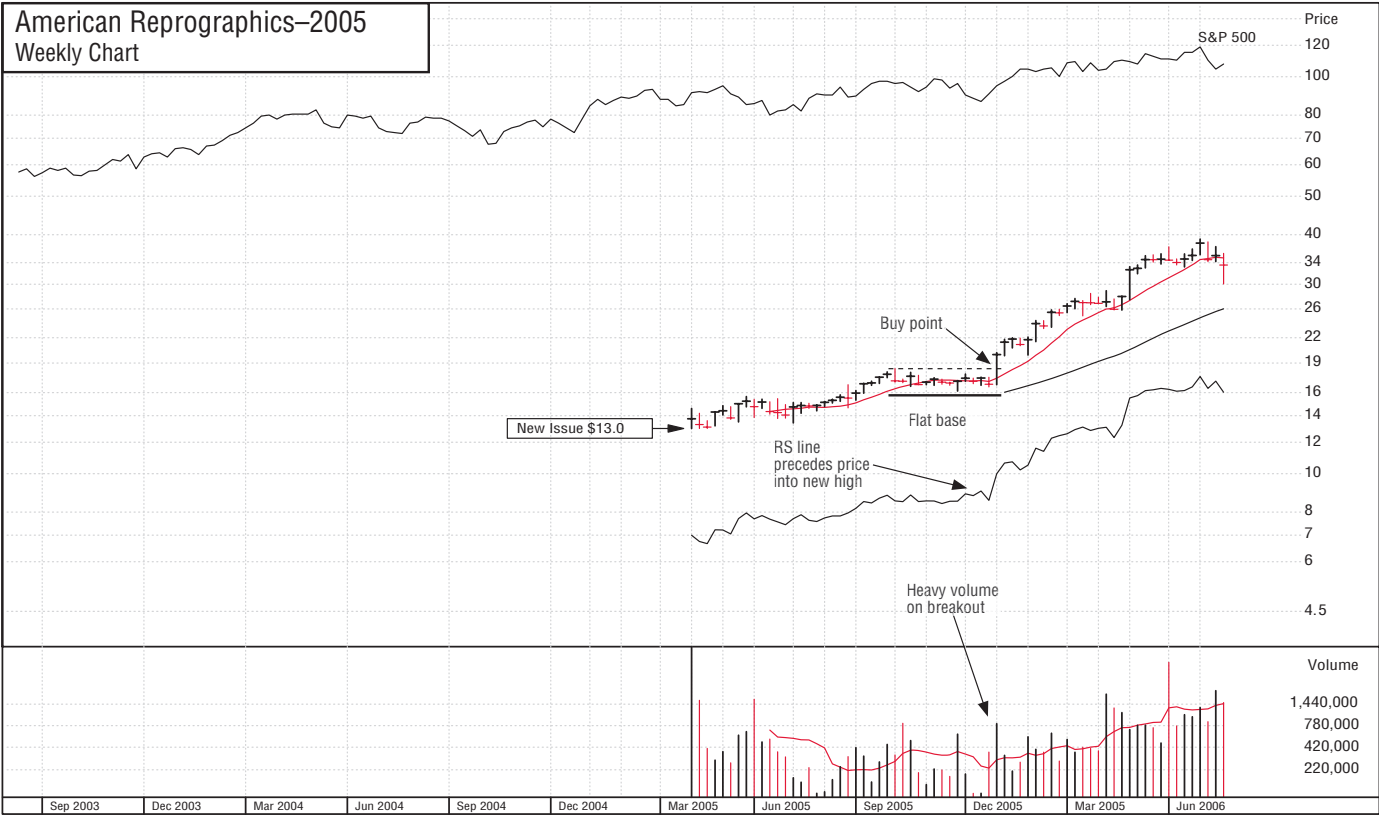


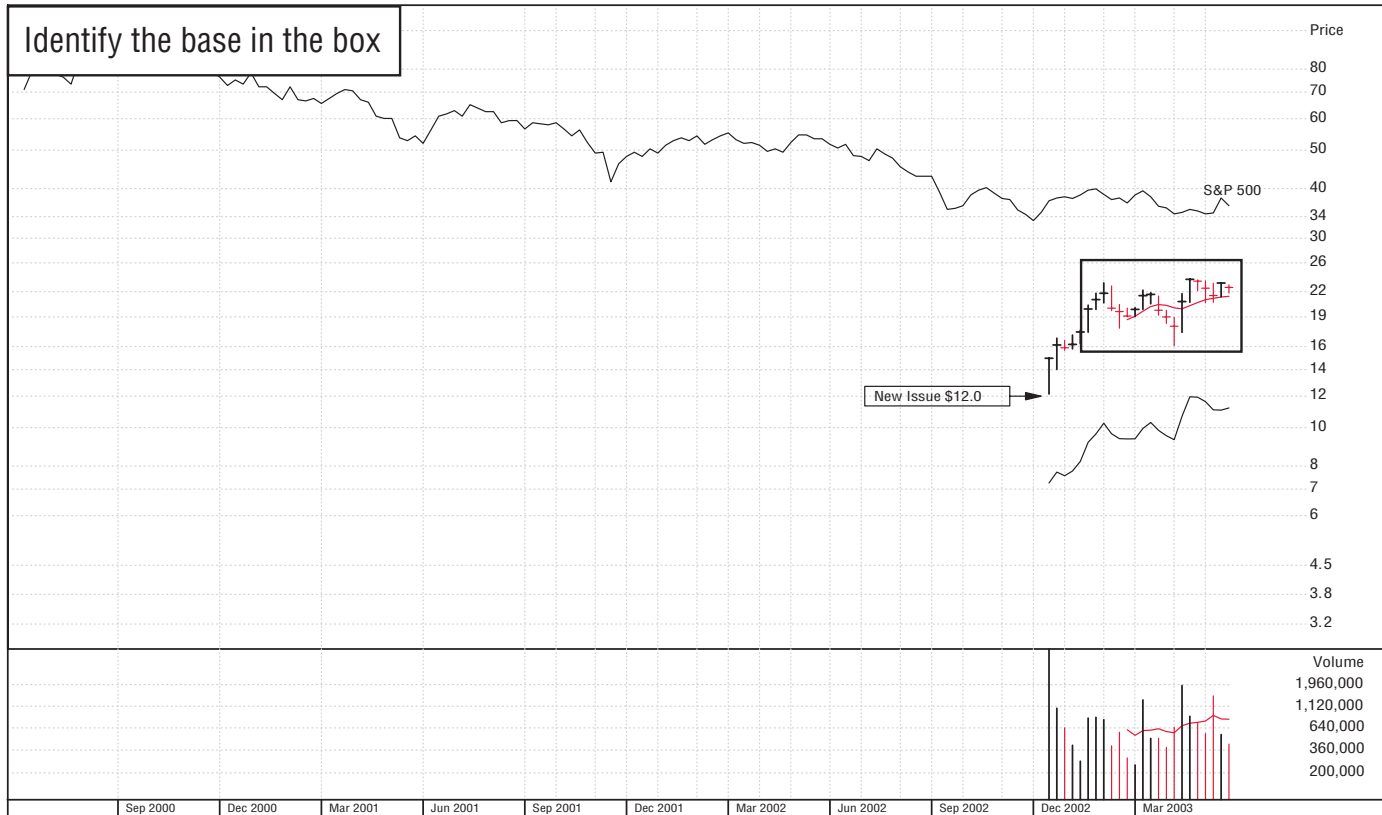
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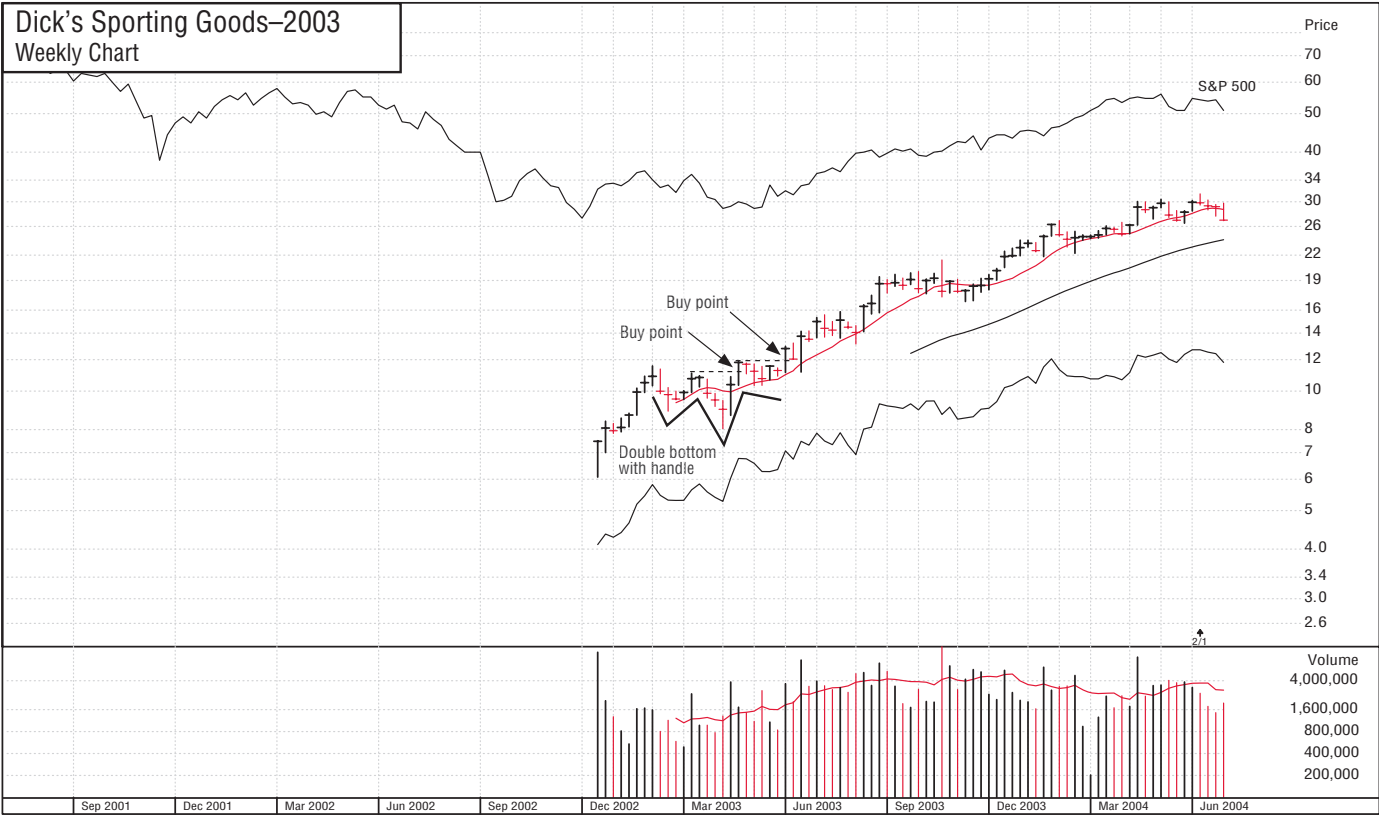


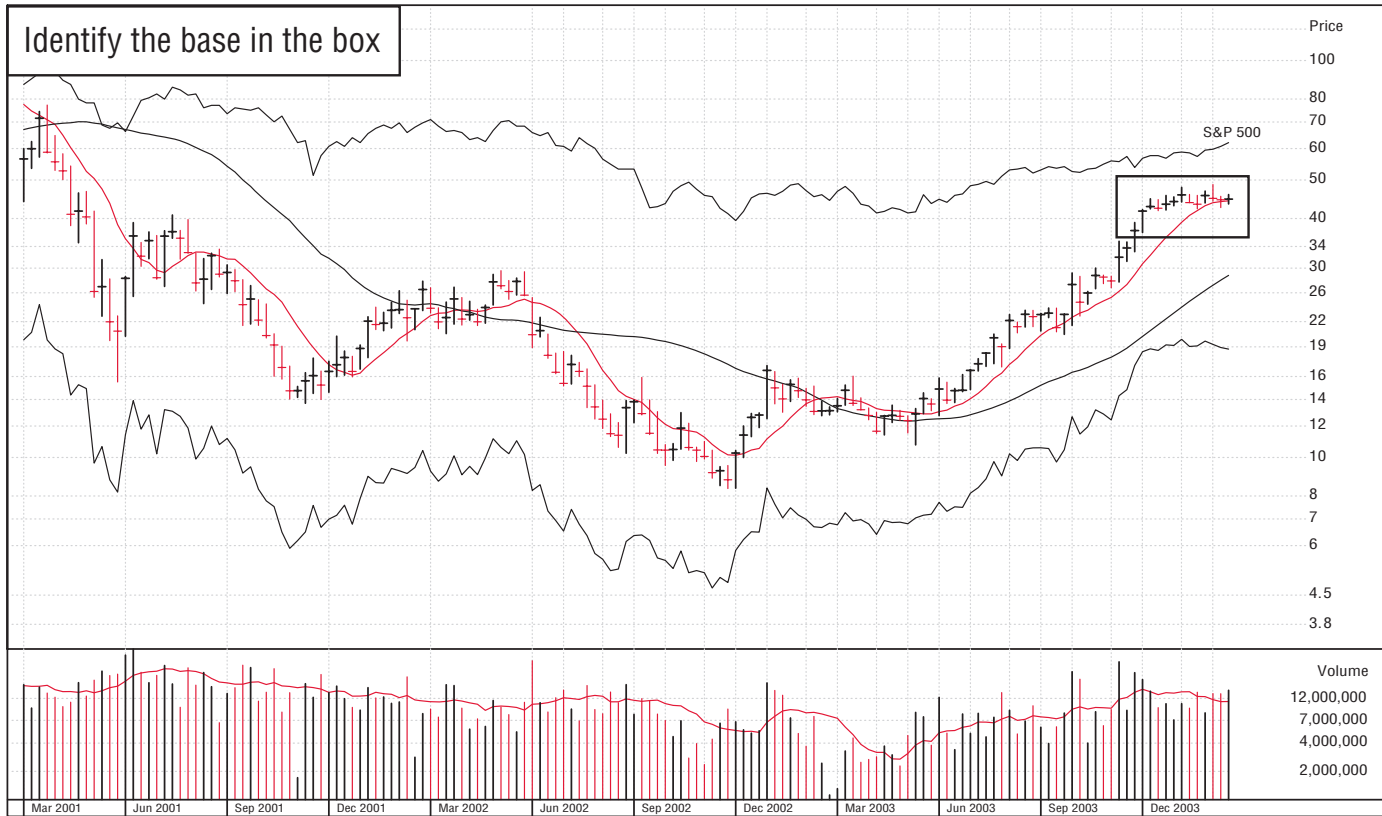
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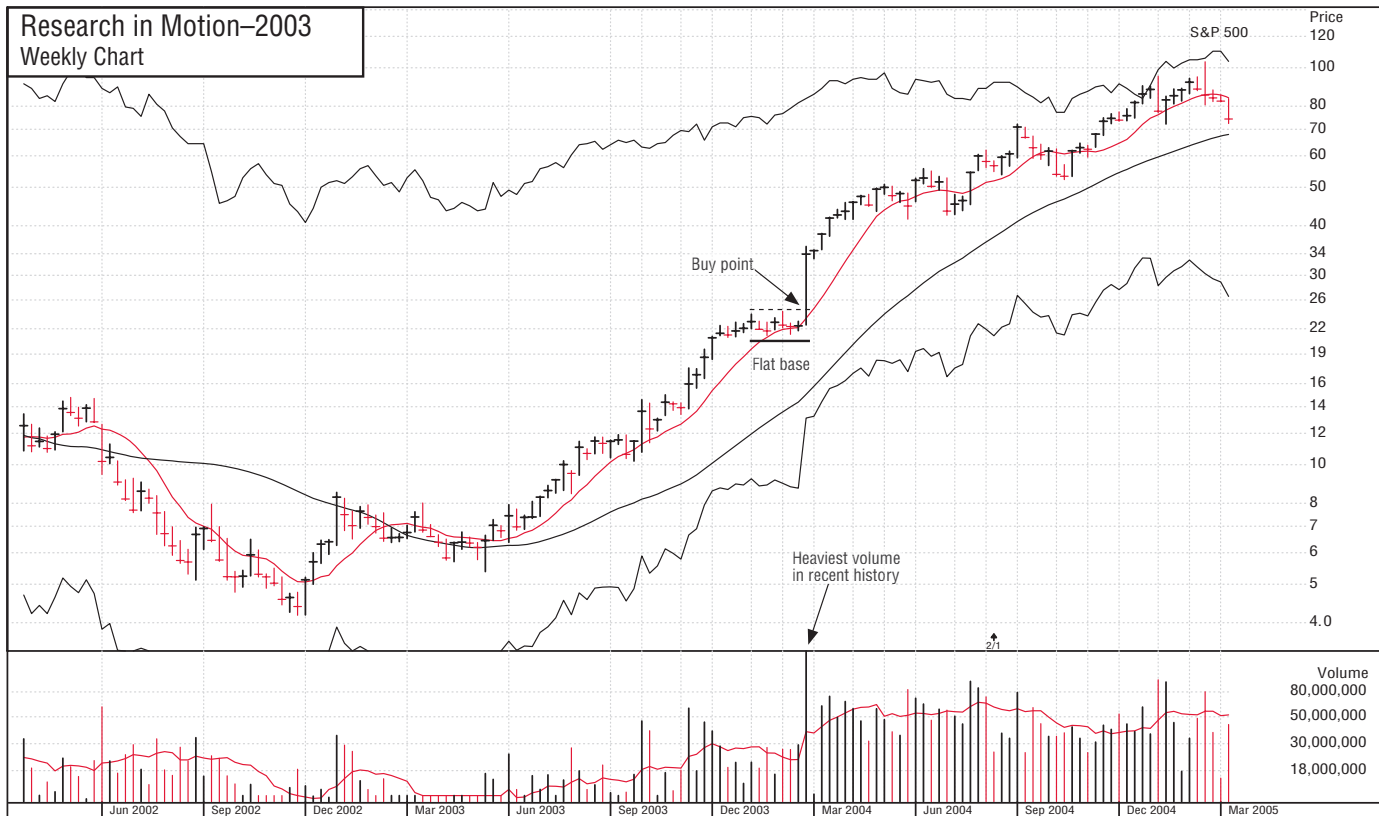


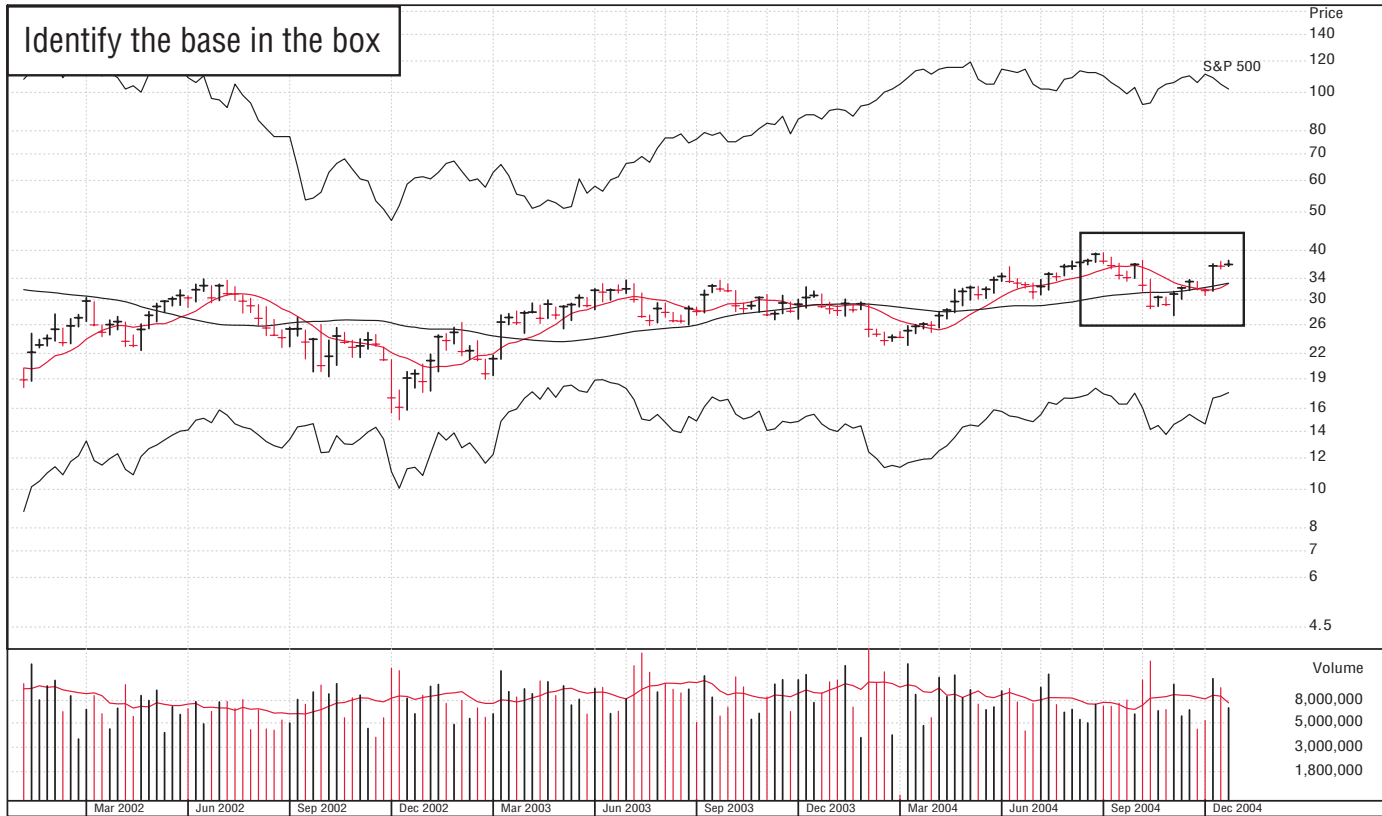
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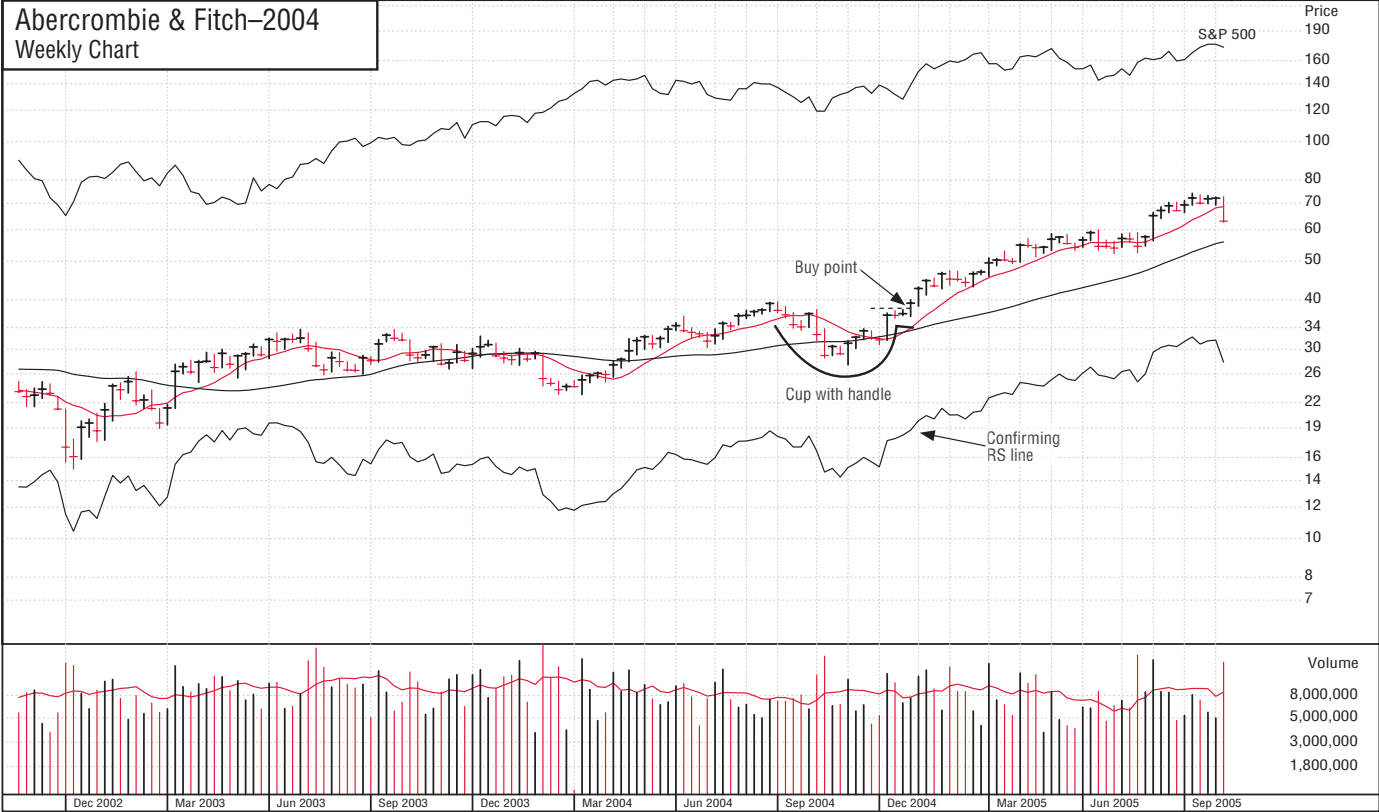
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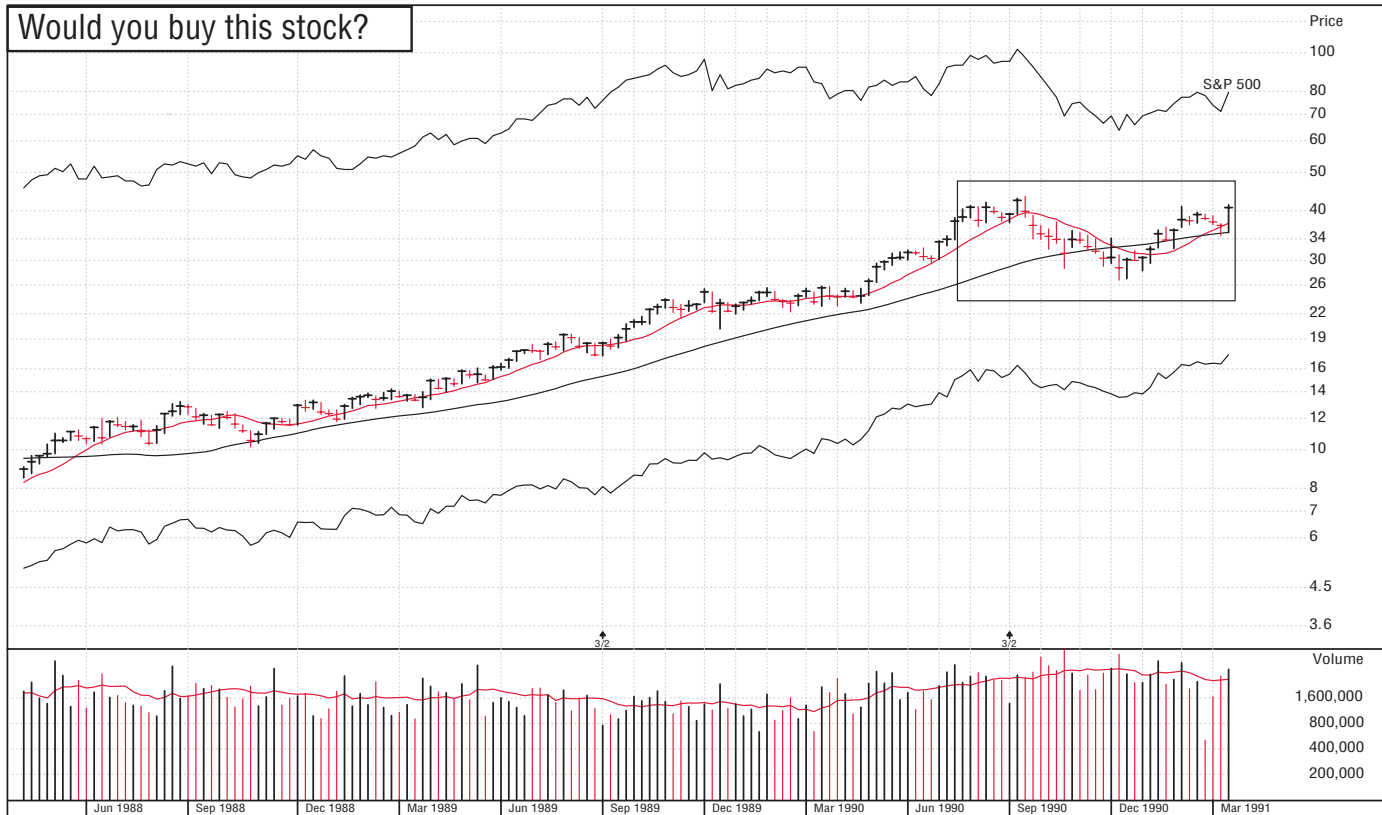


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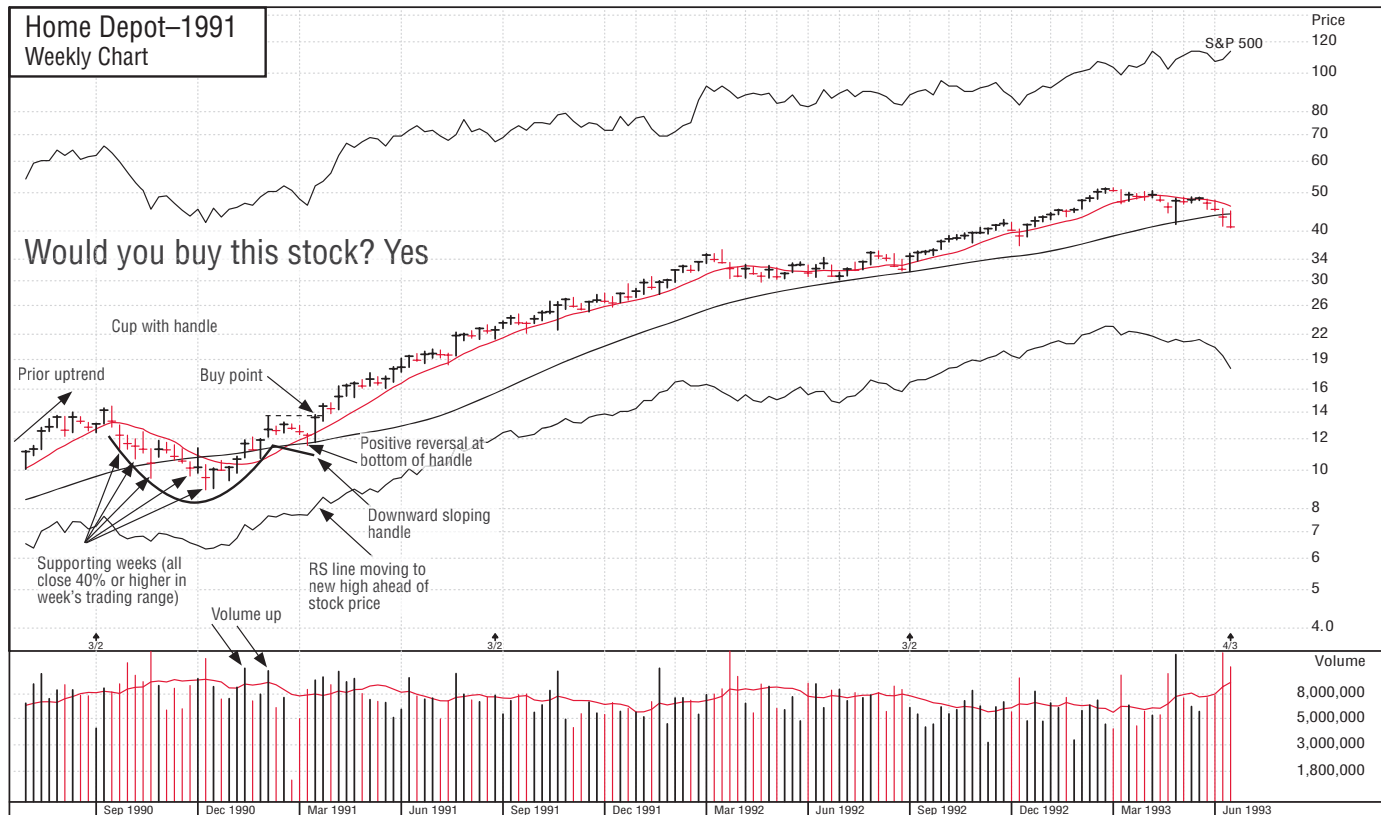
Abercrombie & Fitch–2004
Weekly Chart

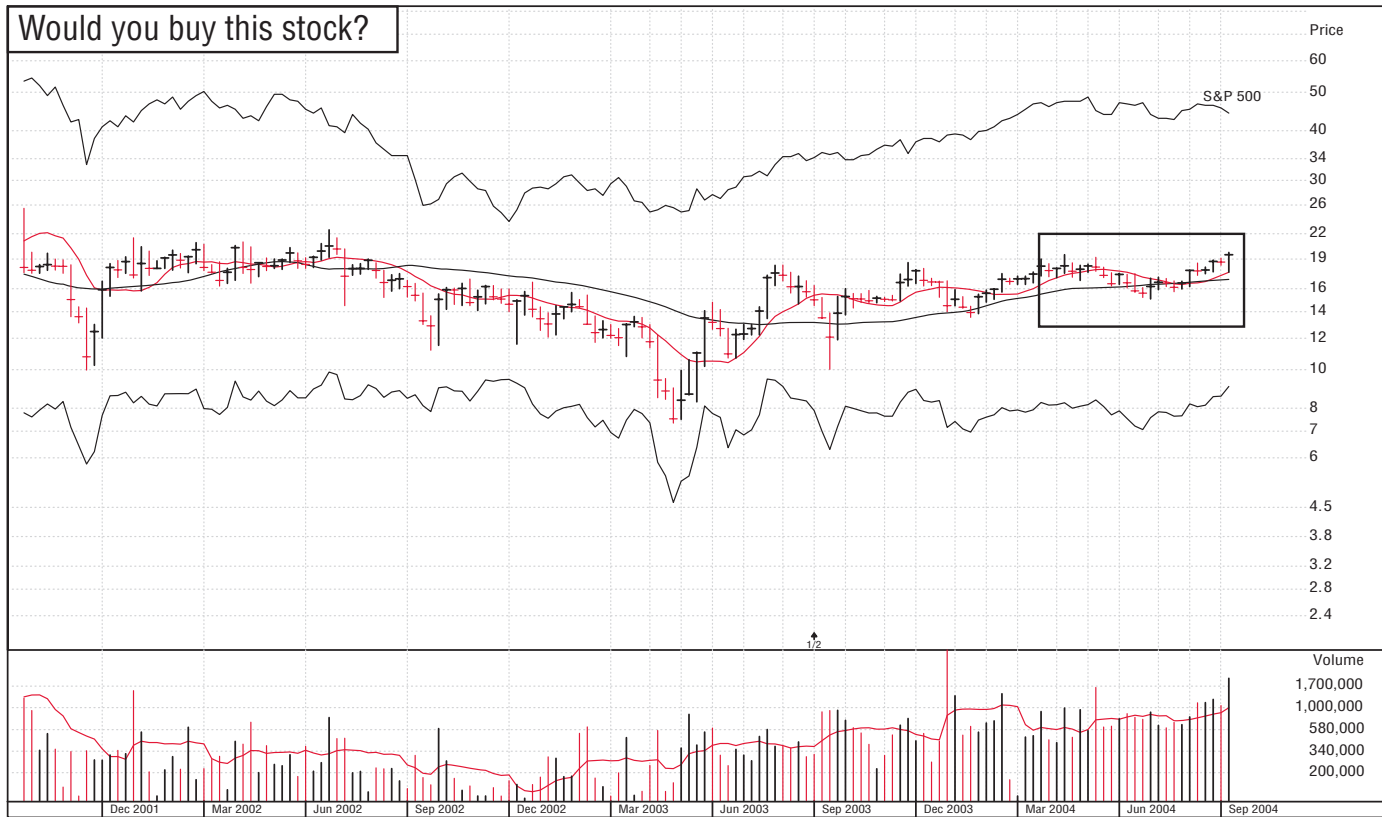


Would you buy this stock?

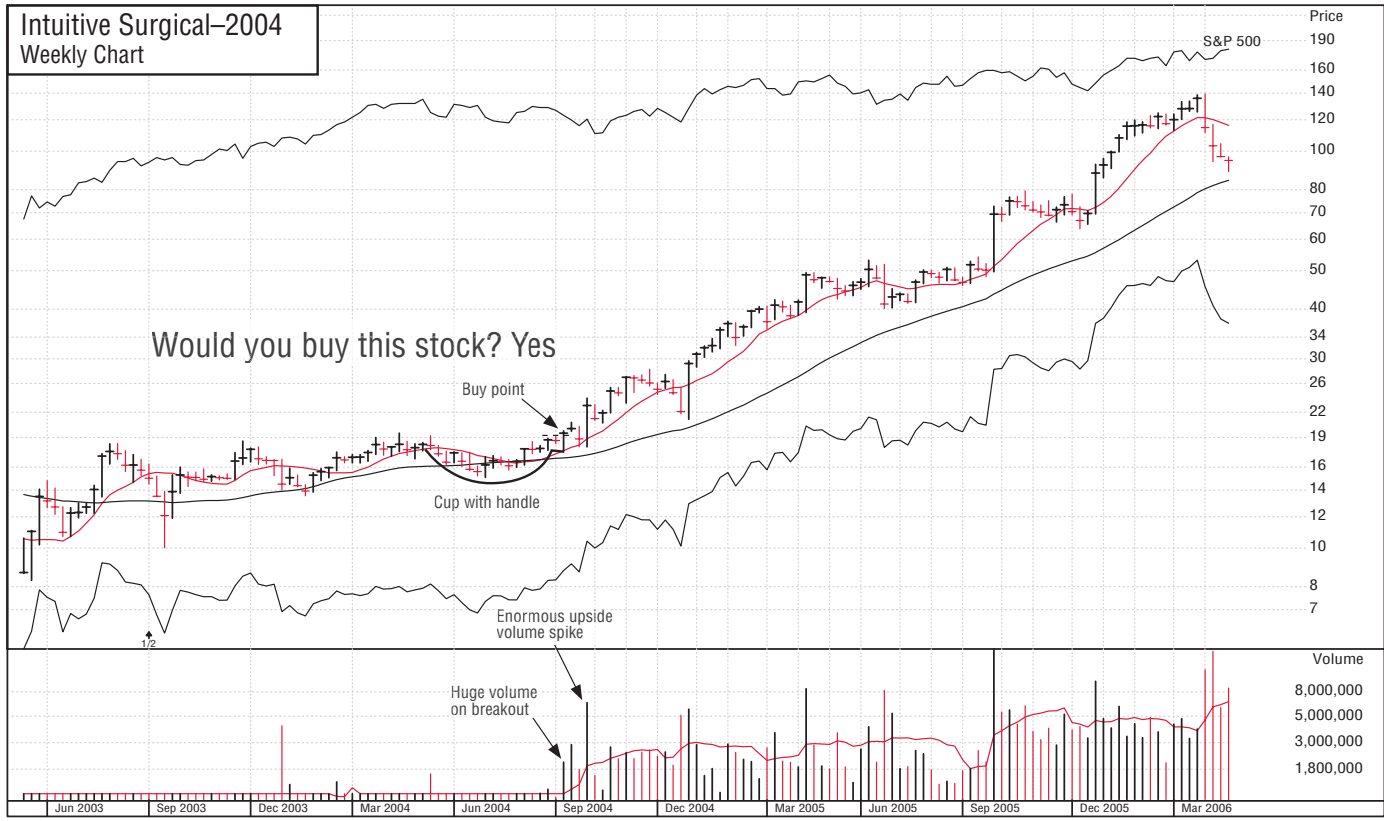


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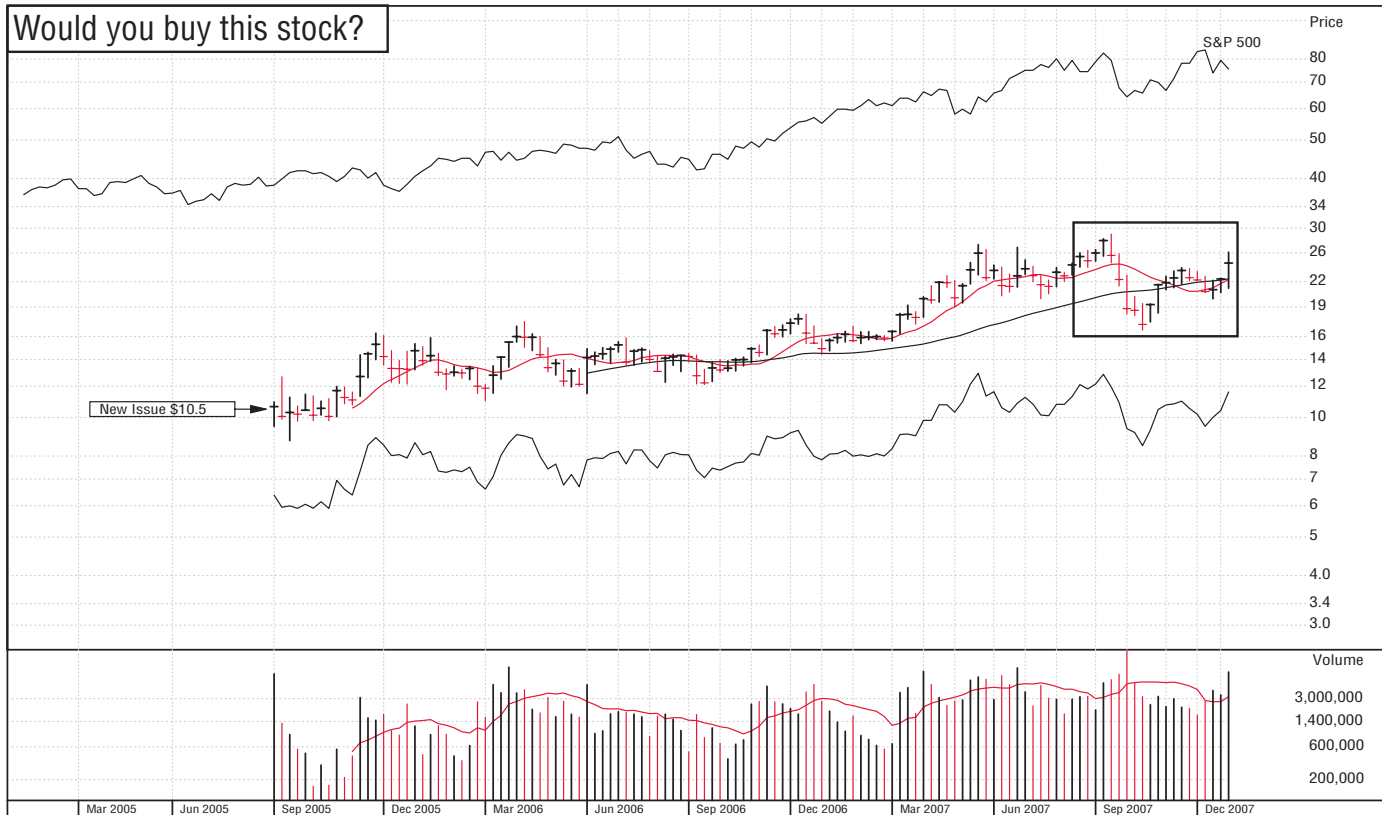




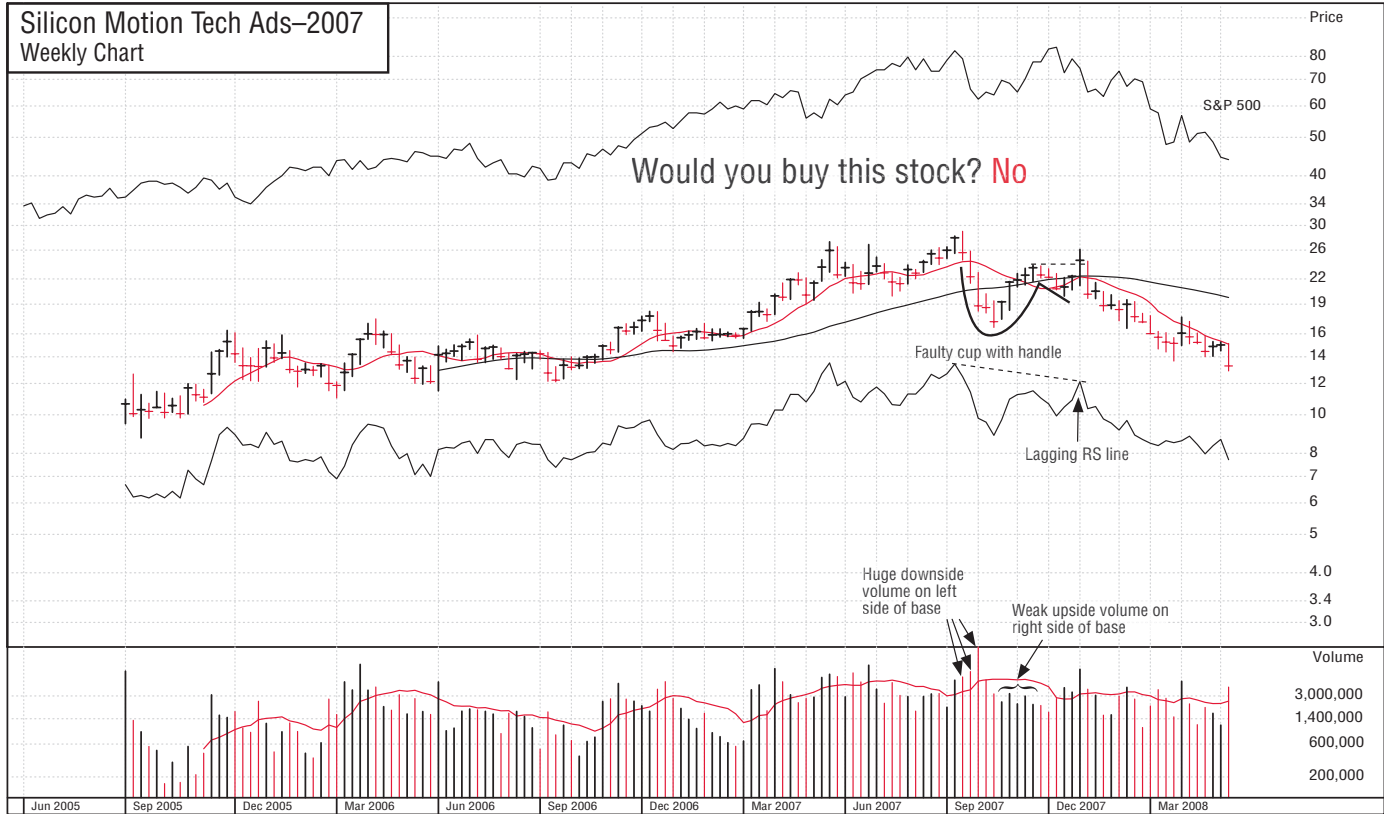
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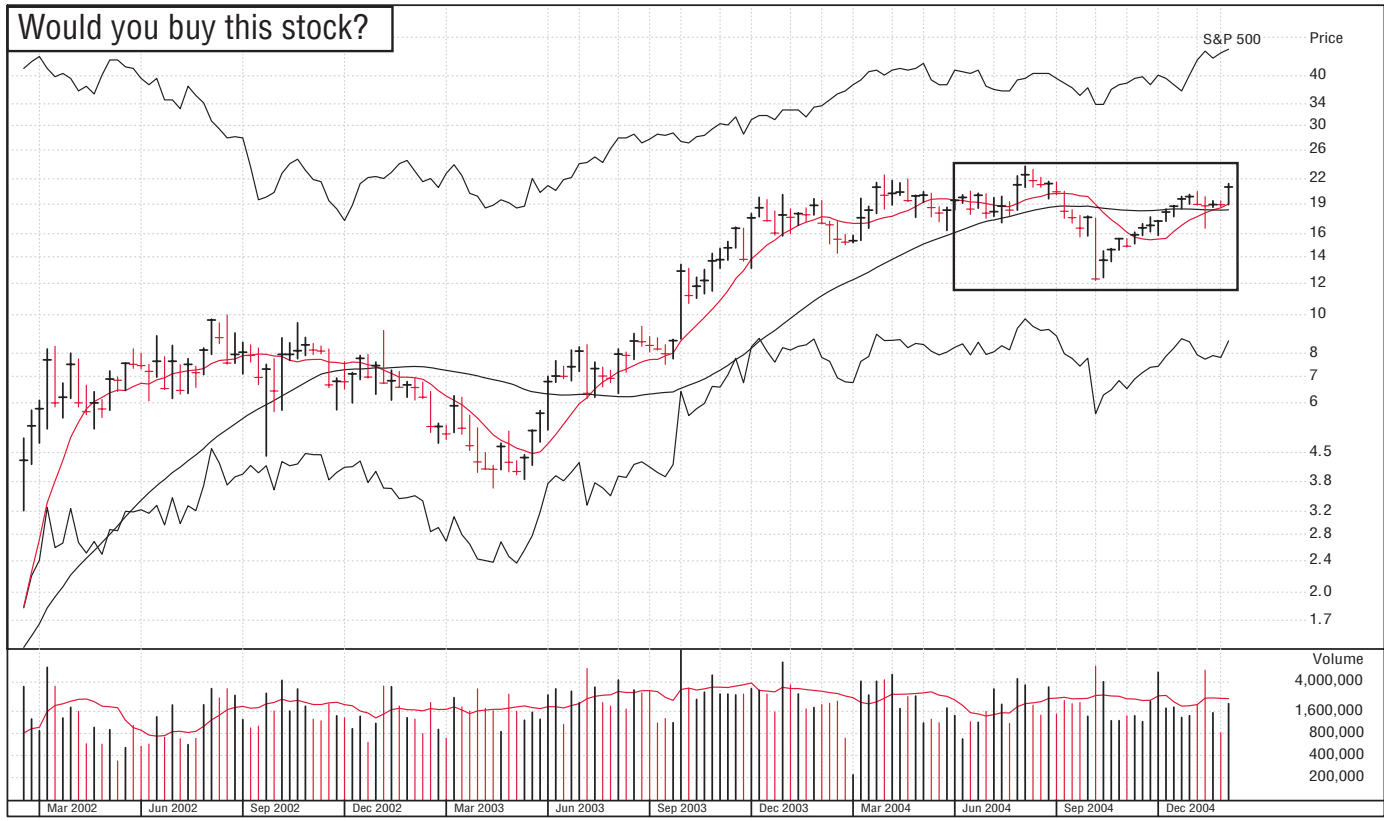
Would you buy this stock?



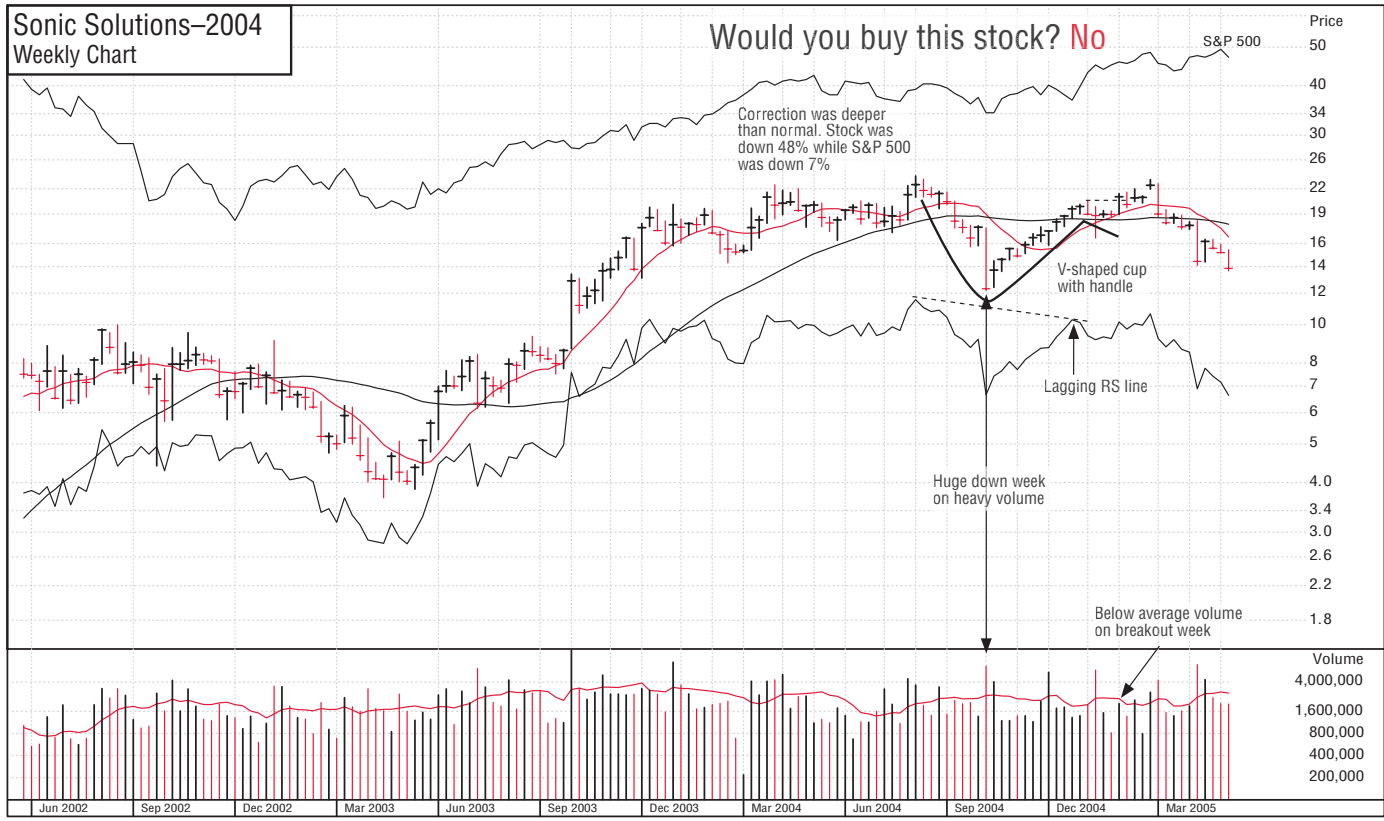
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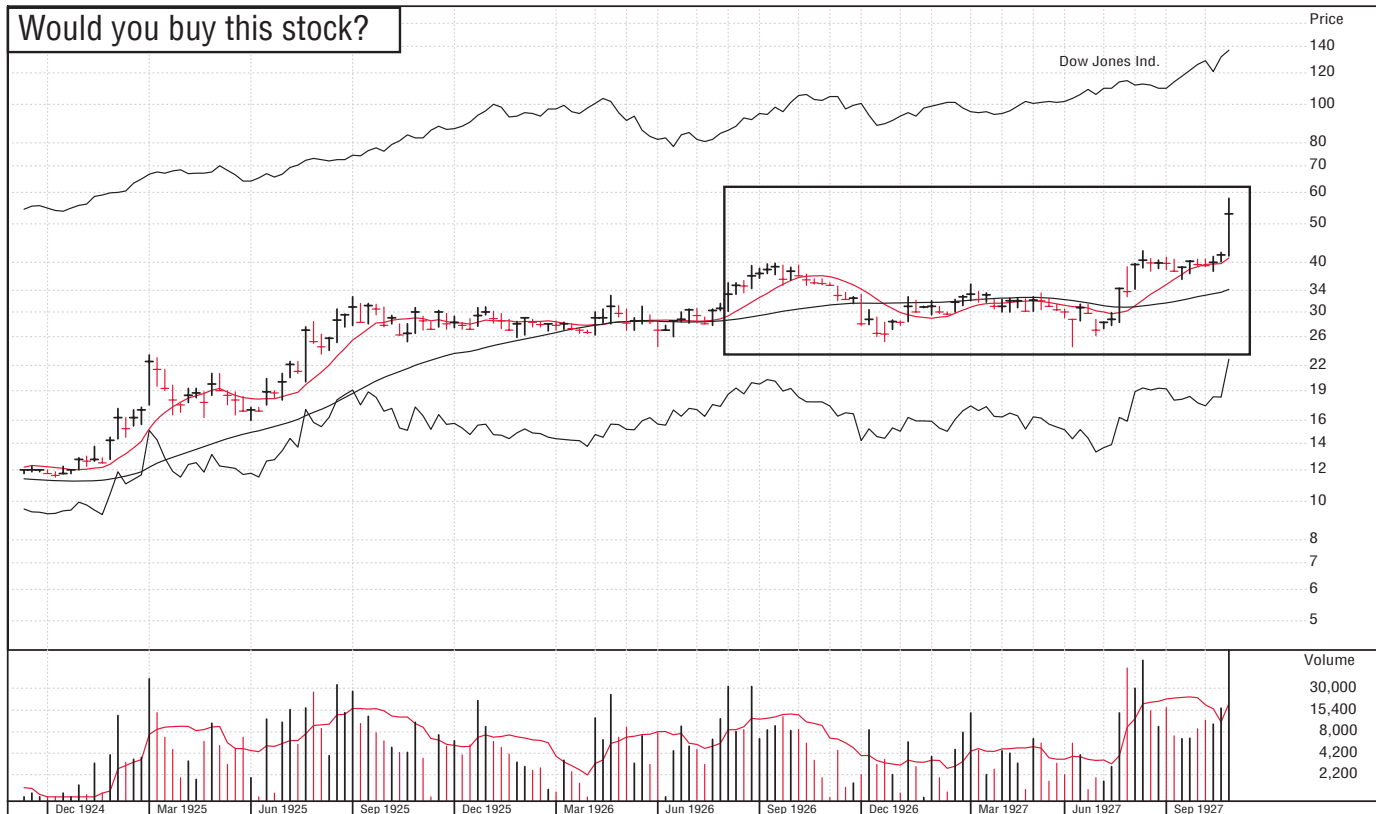


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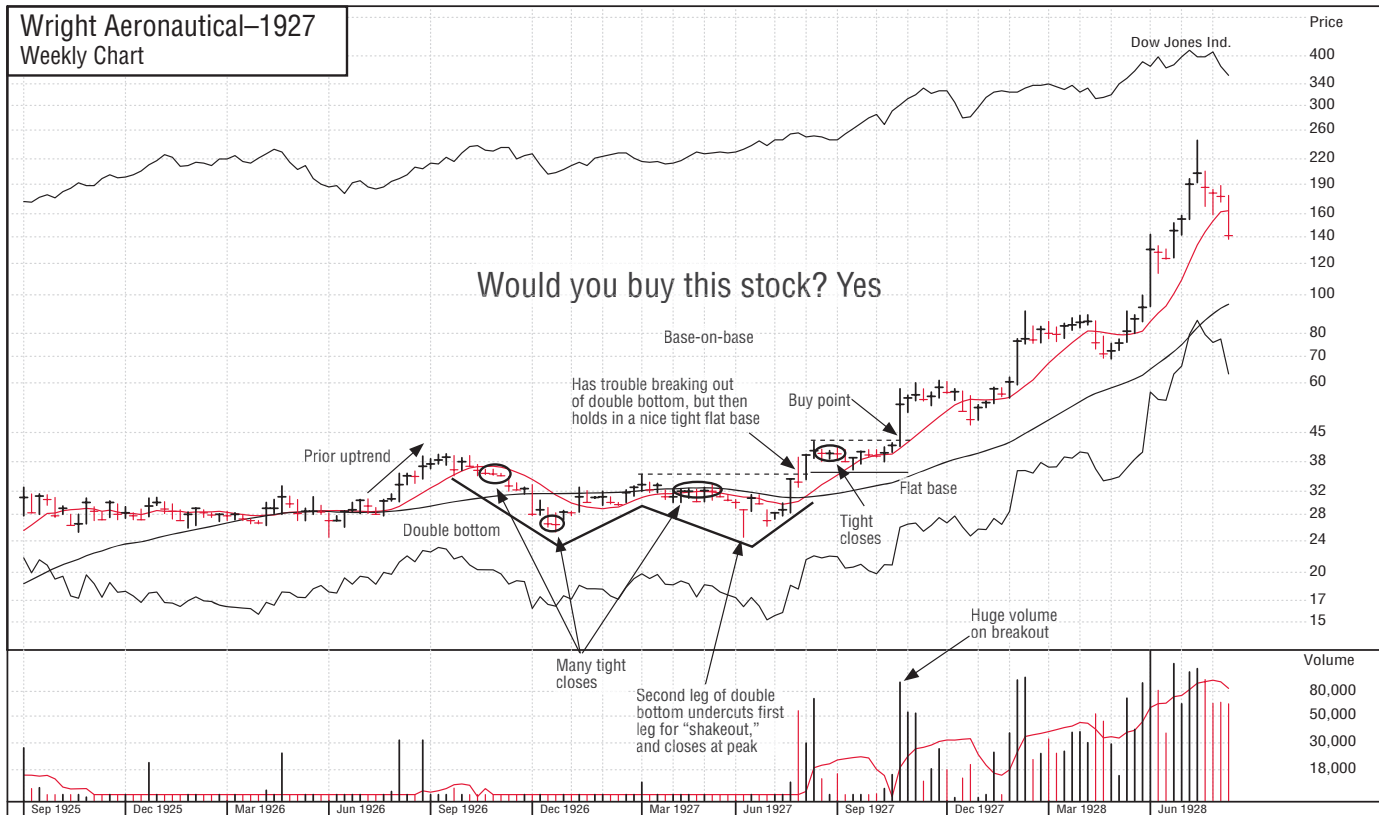


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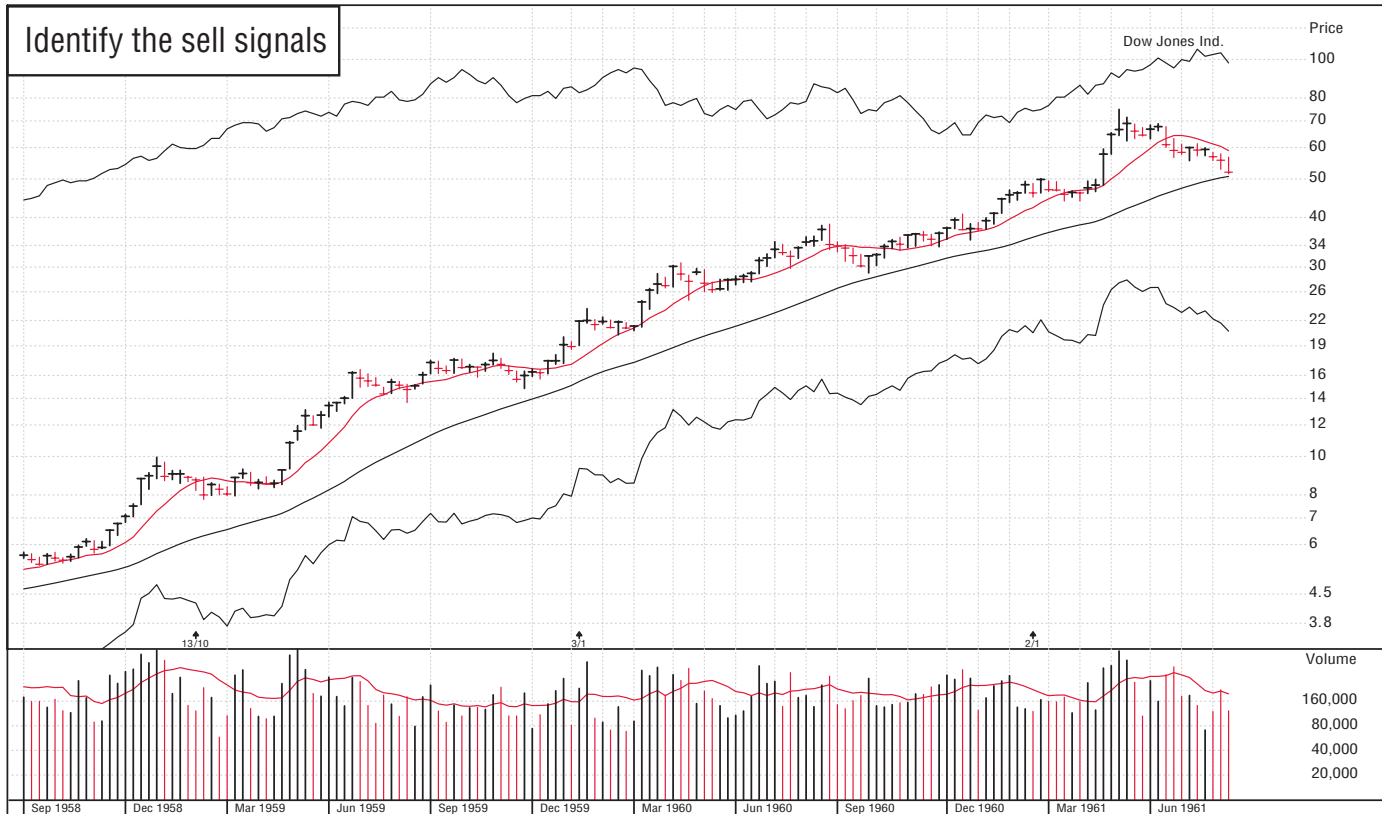
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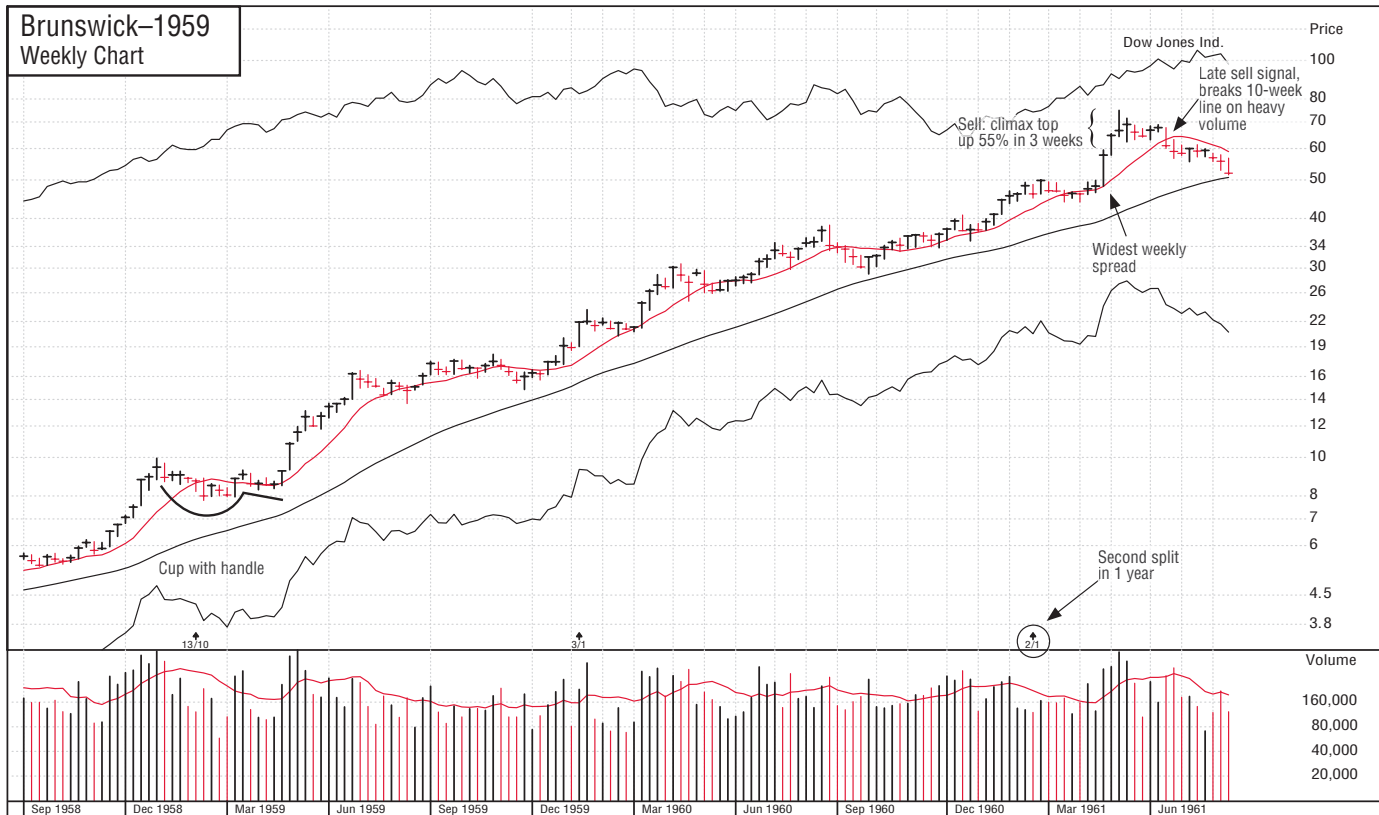
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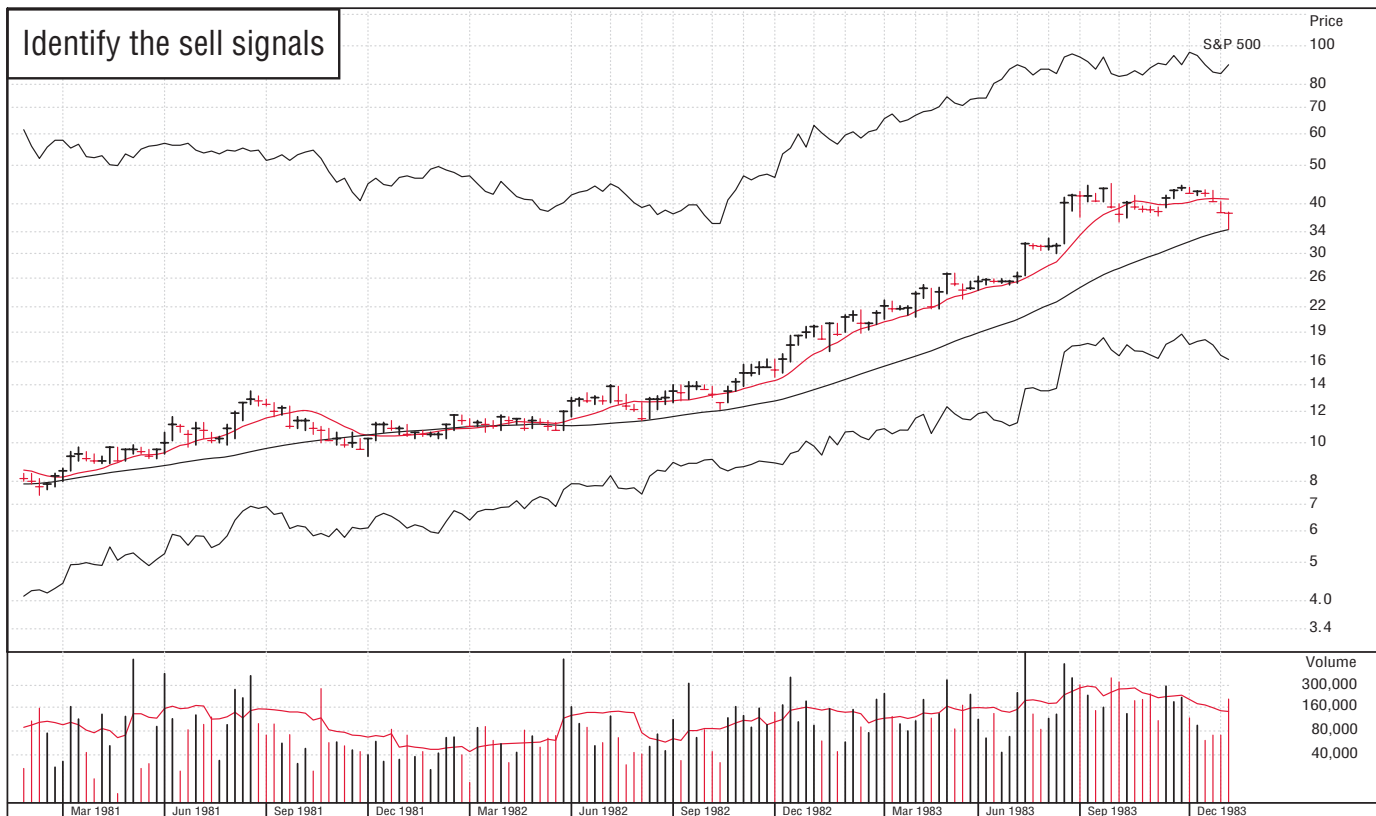
Identify the sell signals



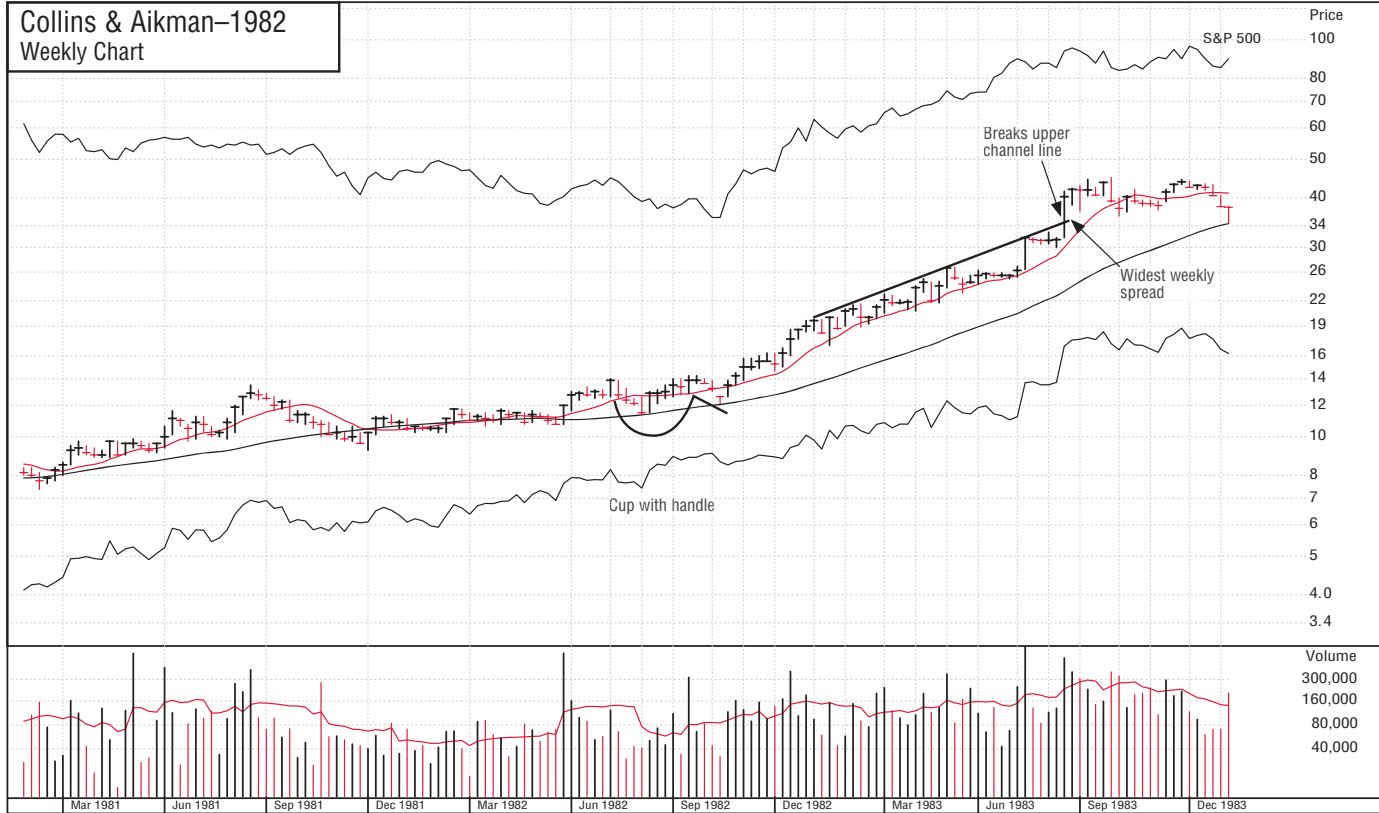
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Identify the sell signals

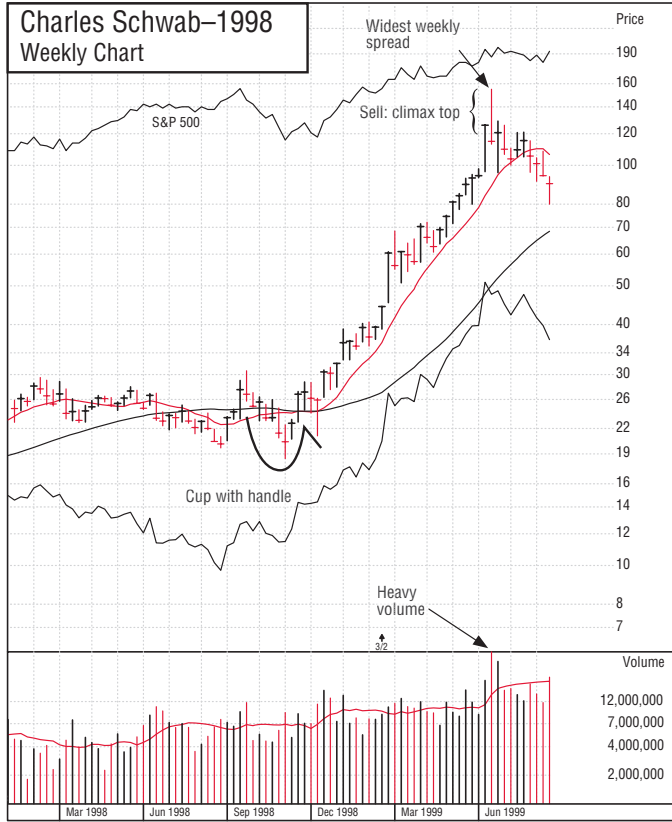


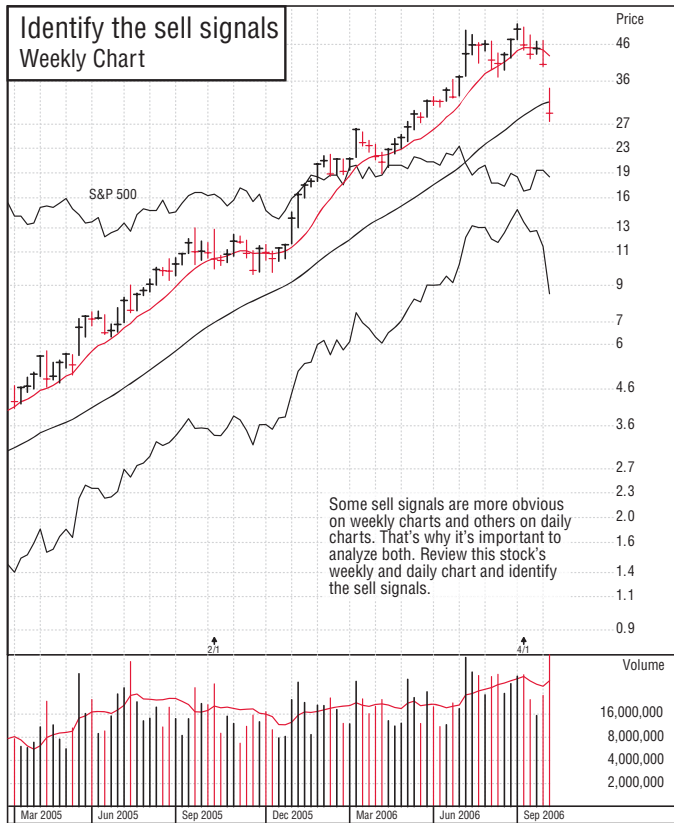
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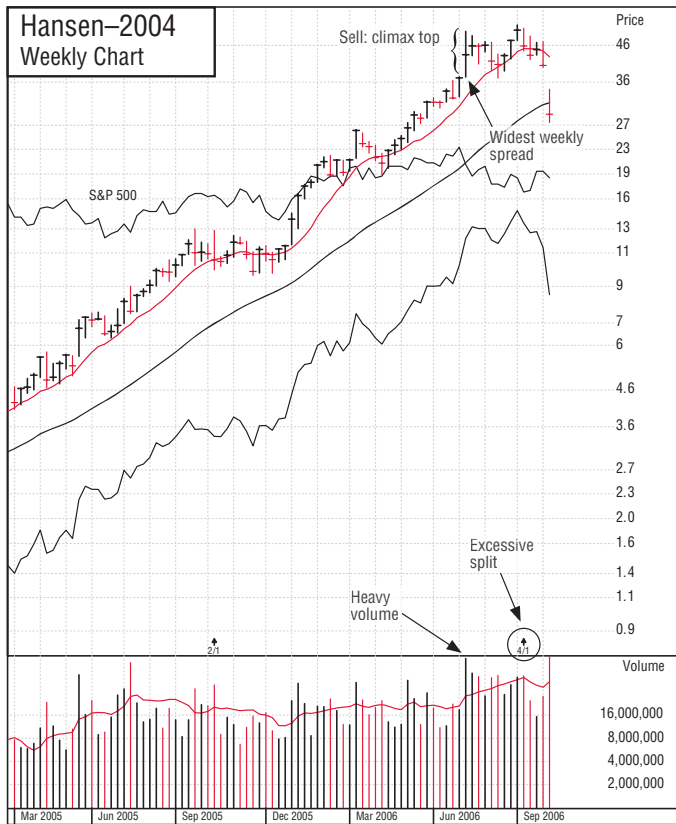


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How to Make Money in Stocks Quiz

1. The “M” in CAN SLIM stands for
 - A. making new highs
 - B. margins
 - C. market direction
 - D. money
2. As recommended by the CAN SLIM Investment System, you should sell a stock if
 - A. it falls 7% from its 52-week high
 - B. it falls 10% from the price at which you purchased it
 - C. it climbs above its 50-day moving average on heavy volume
 - D. it falls 7% to 8% from the price at which you purchased it
 - E. it moves sideways on heavy volume
3. Which of the following indicators generally has the least impact on a stock's price?
 - A. Quarterly earnings growth
 - B. P/E ratio
 - C. Return on equity
 - D. Annual earnings growth
 - E. Sales growth
4. Which of the following is NOT a proper chart pattern?
 - A. Saucer with handle
 - B. Ascending base
 - C. Cup with handle
 - D. Double bottom
 - E. Triple bottom
5. It is recommended that a stock have at least _____ return on equity.
 - A. 15%
 - B. 25%
 - C. 17%
 - D. 30%
 - E. None of the above

- 6.** It is recommended that a stock have had a prior uptrend in share price of at least how much?
- A. 100%
 - B. 60%
 - C. 30%
 - D. 10%
- 7.** In the cup-with-handle base, which of the following is true?
- A. It is more U-shaped and is at least 7 weeks in duration
 - B. It is more V-shaped and is at least 16 weeks in duration
 - C. The shape of the cup with handle is not important
 - D. It is more U-shaped due to a shake out of weaker investors
 - E. None of the above is true
- 8.** In a proper cup-with-handle base, the handle should form at a price that is
- A. 7% above the previous high
 - B. 10% above the previous high
 - C. 15% below the previous high
 - D. 25% below the previous high
- 9.** Typically, a “climax top” is reached when a stock’s price has moved up for many months, then it moves _____ in one to three weeks.
- A. up 15% to 25%
 - B. down 15% to 20%
 - C. down 10% to 15%
 - D. up 25% to 50%
 - E. None of the above
- 10.** Regardless of the type of base, the breakout should occur on volume that is
- A. at least 25% above the average volume
 - B. at least 60% below the average volume
 - C. at least 40% below the average volume
 - D. at least 50% above the average volume
 - E. at least 20% above the average volume
- 11.** A flat base is defined as a sideways chart pattern where a stock corrects no more than 15% over a minimum period of
- A. 3 weeks
 - B. 5 weeks
 - C. 7 weeks
 - D. 8 weeks

- 12.** How many pullbacks occur during an ascending base?
- A. 1
 - B. 2
 - C. 5
 - D. 3
- 13.** You should not chase a stock when it is extended in price more than ____ past a correct buy point.
- A. 3%
 - B. 5%
 - C. 7%
 - D. 10%
- 14.** In this chart pattern, a stock usually doubles in price over a four-to-eight-week time period:
- A. Base on top of a base
 - B. High tight flag
 - C. Ascending base
 - D. Flat base
- 15.** In a double bottom base, the “shakeout” occurs
- A. at the second bottom
 - B. at the first bottom
 - C. just prior to the pivot point
 - D. when the current stock price equals or exceeds the previous high
- 16.** ____ out of 4 stocks follow the trend of the general market.
- A. 1
 - B. 2
 - C. 3
 - D. 4
 - E. 5
- 17.** Most of the trading activity in the market is done by
- A. individual investors
 - B. day traders
 - C. hedge funds
 - D. institutional investors
- 18.** Which of the following are signals that a stock may be topping?
- A. Climax top
 - B. Lagging relative strength
 - C. Change in trend
 - D. All of the above

- 19.** A technical characteristic of a weakening stock is
- A. a stock that has its highest P/E ratio in the past year
 - B. a stock that is slipping below its 50-day moving average as volume increases
 - C. a stock that is reporting decelerating quarterly earnings
 - D. a stock that reaches its highest price in the past 12 months
- 20.** In a bull market, if the majority of individual stock leaders start breaking down, this usually signals a
- A. climax top
 - B. market top
 - C. base building period
 - D. market bottom

Answer Key

1. C
2. D
3. B
4. E
5. C
6. C
7. A
8. C
9. D
10. D
11. B
12. D
13. B
14. B
15. A
16. C
17. D
18. D
19. B
20. B

We hope that you found this bonus section valuable. Remember, learning to read charts and identify bases takes time, but the more charts you look at, the better you'll get at spotting stocks with the potential for big price gains. Plus, there are many free resources available on Investors.com to help you:

- Investors.com offers oversized, color charts to make it easier to recognize bases and identify exact buy points.
- IBD TV provides daily videos highlighting specific stocks as well as lessons on how to read charts.
- IBD University provides additional education content on the CAN SLIM Investing System, fundamental analysis, and general market analysis.

Also, IBD Meetups bring CAN SLIM investors together in communities throughout the nation. The Meetups are a fun way for investors of all experience levels to get together and discuss IBD's approach, specific stock ideas, and the general market. Learn more at www.investors.com/meetup.

Learning to invest the right way does take some time, but tens of thousands of people just like you have used the CAN SLIM Investing System and the tools available from IBD and Investors.com to be more successful in the stock market. You can do it too!

Success Stories

Over the course of 25 years and counting, *Investor's Business Daily* has heard from countless readers who have experienced life-changing financial success because of the CAN SLIM and IBD method. The following is a small sample of the thousands of success stories we've received over the years from people of all ages and experience levels. It's a powerful testament to the fact that with a little hard work, patience, and dedication, anyone can learn to follow this system to improve their results.

Market Timing

"IBD is a proven and no-nonsense approach to investing. This system has helped me find the big winners in a market rally, and more importantly, it has helped me avoid the big losses in a market downturn. This, in turn, has allowed me to retire in my early fifties, spend more time with my family, work on my hobbies and interests, and generally lead a very happy life."

Michael A., Florida, Retired

"I shared IBD's 'The Big Picture' recommendation to trim equity holdings and raise cash in December 2007 with my 'smart friends' (attorney and financial services manager). I reiterated the fact that IBD had had the same market call in January 2000. While my friends and colleagues were chasing financials (see falling knife), my wife and I were able to buy quality CAN SLIM stocks at proper breakpoints. Suffice it to say that my wife and I

have had a great year being in cash for most of 2008. Thanks, IBD! Rest assured, you may have two more subscribers on the way!!!”

Ken C., California, Financial Advisor

“I’ve been a follower of IBD for around 17 years. A serious follower for the last four years. In 2007, I achieved a return of +56% in my trading account, and I broke even in 2008 by staying out of the market for most of the year. The system has never failed me. The paper’s content, format, and teachings have only gotten better over the years.”

Eric M., Illinois, Engineer

“I have been a reader of IBD since 2005 and have profited immensely from it. Also, I have attended more than five IBD workshops from level 1 to level 3, and each has made me a better disciplined investor. The CAN SLIM system, a system that works great whether in good times or bad times.”

Rajesh S., Texas, Electrical Engineer

“I’d like to take a moment to thank IBD for ‘The Big Picture’ and the market outlook. I’m a federal employee with a 401(k) plan called the Thrift Savings Program. We are limited to five basic funds. The government or ‘G’ Fund is invested in government securities and is our safe haven. The ‘C’ Fund is our S&P 500 stock fund, the ‘F’ Fund is our commercial bond fund, the ‘S’ Fund is our small-cap fund, and finally the ‘I’ fund is our international fund. By using ‘The Big Picture’ and market outlook, I was able to follow the general market trend and move all of my retirement funds out of the market and into a cash position in the ‘G’ fund. While most of my coworkers suffered huge losses in the market and the market in general lost over 35%, my total return for 2008 was up 4%. I simply check ‘The Big Picture’ every day and move my money either into or out of the market using market outlook information. Again, thanks for your hard work.”

Brian D., Florida, Supervisory Special Agent

No Opinions, Only Facts

“In describing IBD, I would say it is without doubt one of the best sources of information for investors that is available for the money. You don’t get any ‘Wall Street’ spin on the markets from IBD. It gives you the straight stuff. By that, I mean IBD tells you the truth about the markets, economy, political events, etc., that affect the markets, whether positive or negative. That is huge in this climate because there is a lot of ‘Financial Nonsense’ being fed to investors by too many unreliable sources these days. IBD tells investors the truth. You can count on it!”

Steve C., Texas, Ophthalmologist

“IBD and Investors.com let you focus on what the market is actually doing at any given moment, allowing you not to have to listen to all the noisy fortune tellers on the tube.”

Norm D., California, Individual Investor

“IBD is a tremendous time-saver. I make it a part of my daily process to read IBD every business day, even if I do not read anything else. It is a great way to quickly get a feel for the general market direction, continue to remain educated, and learn about the secrets of success that keeps me motivated. Where else can you get that in about 15 minutes a day? It is an extraordinary publication!”

George M., California, Executive

“To me, *Investor’s Business Daily* is an outstanding market analysis resource because it is based on objective empirical research that cuts through pundit opinions and personal emotions in buying and selling stock. Its greatest strength is its direct, clear-thinking presentation of market-relevant news that leaves often confused approaches of other publications behind.”

Allen A., Connecticut, Ph.D.

CAN SLIM

“Just studying IBD and CAN SLIM shows that if you really apply yourself properly, you can succeed. You don’t have to be at the mercy of so-called experts who really aren’t. I don’t like the intimidation tactics or the pressure tactics of the money managers. There are no guarantees in investing, but with IBD and CAN SLIM, the odds are on your side.”

Carol T., Massachusetts, Anesthesiologist

“I have been trading stocks full time since 2003, thanks largely to William O’Neil’s *How to Make Money in Stocks* and IBD. I have reread the book many times and am rereading it again. It is full of different-color marks, as each time I read it I find something new and useful. I must say, *How to Make Money in Stocks*, the IBD subscription, and the online tools are essential to successful stock trading. Just like people grab their family photo albums from the house on fire, if I were to pick just one thing to assure my continued success in stock trading, it would be William O’Neil’s *How to Make Money in Stocks*.”

Slav F., California, Stock Trader

Proven Rules

“*Investor’s Business Daily* is a source for useful and accurate information about how the market works. I have found that following the buy and sell

rules works. If you follow those seemingly simple but at times hard to follow rules, you will make money.”

Herb M., Michigan, Individual Investor

“It was only when I started properly applying the IBD sell rules that I realized the power to not only cut losses short, but stay away when conditions are not good for making money. A day without IBD is a day of missed opportunity.”

Dennis H., Florida, Retired Broker

“William O’Neil taught me the two rules that form the cornerstone of my investing plan: (1) keep your losses small, and (2) average up, never down. Those two simple rules have kept me out of a lot of trouble. When I have strayed from them, it inevitably cost me money. Thank you, Bill, for all you have done for the average investor.”

Peter M., California, Executive

Investor Education at Its Best

“I have gone to great lengths to learn about investing. I attended business school as an undergraduate and graduate student, and worked for a retail brokerage firm and for a small-cap research firm that supported institutional clients. Even after all this experience, it wasn’t until I read *How to Make Money in Stocks* that I began to understand how to succeed in the market.”

Andrew M., New York, Vice President

“My students were participating in the Stock Market Game and struggling with losses. Then they started using *Investor’s Business Daily*. IBD helped my students reverse big losses and win third place in the Stock Market Game. IBD has helped motivate my students to get great information in an easy-to-use format. It’s given them the tools to research and make investment decisions, and become their own independent investors.”

Stephen D., New York, High School Teacher

“I’ve been a subscriber to *Investor’s Business Daily* since 1991. This is investor education at its best. I fired my broker two weeks after I got IBD. I told him I didn’t need him anymore. I trade over 150,000 shares each year. I used to have no savings, but because of IBD, my net worth is well over 1 million dollars. I run it as a business. I’m just an average guy, I’m not a genius, but I study a lot and use IBD. That’s how I succeed. It’s more than a newspaper; it’s a working document.”

George G., Georgia, Pilot Trainer

“My stock life before IBD had no direction. I had no idea there was anything to learn. Life after IBD opened my eyes, and my mind. I don’t ever expect to stop learning!”

Marilyn W., Ohio, Retired

“Investing without IBD is like trying to live without water. IBD will give you the proper structure to make informed and assessed decisions about the general market or a particular stock issue, intelligently. I have taught the principles of the paper to several hundred of my college students over the past four years, and they have had fantastic results. They do not invest without it, and neither do I.”

James D., Florida, College Instructor

“Spend a year learning everything there is to learn in IBD. It’s like getting your doctorate in investing without going to four schools. It’s the easiest, quickest way to become a savvy investor, regardless of how much you have to invest.”

Julie P., Colorado, Author, Nutritionist

“I have been subscribing to IBD since first studying stocks about 1990 and would not do without it. I read it every day, and it is like my right hand.”

Averie M., Florida, Retired

“Over my 18 years of teaching junior high, high school, and college, I have used a wide variety of texts, videos, Web sites, newspapers, magazines, computers, and board games in teaching my students about investing. Without question, IBD has been the most exciting and pertinent resource I have ever used on the basis of student success in investing as well as student motivation to use the resource.”

Mike S., Texas, Teacher

Real Performance

“I figure I’ve made more money in stocks using IBD as my daily resource than I’ve made as a CPA over the last 10 years.”

Robert F., Illinois, CPA

“With Bill O’Neil’s guidance, I was able to reach my goal. I now can enjoy and support my 12-year-old twin sons, trading stocks as a single, work-at-home Dad. Bill’s stock wisdom allowed me to grow and protect my hard-earned money plus enabled me to live a more rewarding lifestyle.”

Tim K., California, Chief Investment Officer

“I’ve been reading IBD since its inception. I started with \$5,000, and three years later, it escalated to \$50,000. Why? Because of IBD. Need I say more?”

Fred B., New York, Arbitrator

“Since I started using CAN SLIM and IBD, and now Investors.com, I was able to make 359% on my original investment! IBD has so many features that help me find the great stocks. I’m grateful for all the work you do to help investors.”

Kathleen P., California, Individual Investor

"I subscribed to *Investor's Business Daily* for the first time after I retired. I started using it for my stock portfolio because I wasn't happy with my brokers. With them, my portfolio was racking up losses. With IBD's help, over time I was able to get my portfolio back in the green with 20% and 30% gains. I took a portfolio of \$400,000 to \$700,000 thanks to IBD. I love IBD. I talk it up wherever I go."

Don R., Washington, Restaurant Owner

"For more than ten consecutive years, we've realized a compounded 57% annual return. CAN SLIM and IBD played a preeminent role in that success."

Florence R., Texas, Investor

"I started investing more than ten years ago. I was not very consistent until I was introduced to *Investor's Business Daily*. I've been profitable ever since."

Ash M., Hawaii, Business Owner

"After reading IBD, learning the CAN SLIM investing system, and reading IBD founder Bill O'Neil's books, I've become successful enough to be a stay-at-home Dad. Thanks to IBD and CAN SLIM, my dreams have come true."

Eric K., Illinois, Individual Investor

"I have been reading IBD since the late 1990s. I've employed the CAN SLIM rules, and they allowed me to comfortably retire last May. This is the only paper I read for financial investment advice. I continue to recommend IBD to all my investor friends."

Frederick D., Michigan, Retired

"How about an investor up over 130% in 2008? *Investor's Business Daily* is where I look to make it happen!!!"

John B., Illinois, Real Estate Broker

"By following IBD's rules, I have quadrupled my account since May 2003. IBD has also helped me remain flat this year in a severe bear market. The best thing is that the rules are very easy to learn and follow, and I have lost money only when I tried to put my own 'wrinkles' on them."

Edward K., Arizona, Retired Doctor

"Thanks to *Investor's Business Daily* and Mr. O'Neil's CAN SLIM, my 401(k) is still +10%. I have continually kept my losses at less than or equal to 8%. This with taking 20–25% gains with the occasional larger take has resulted in investment success. Thank you."

Don B., Michigan, Retired Anesthesiologist

"Starting in 1999 with \$5K in savings and \$7K in wedding presents, I used the CAN SLIM system to make over seven figures by 2008."

Jonathan S., Tennessee, Individual Investor

"I am glad to say I have kept almost all of my profits from the 2003 bull run thanks to your publication. . . . IBD is an excellent data source about the markets and can help individuals and professionals make better decisions about how to invest their money."

Bruce W., California, Attorney

"With my knowledge from IBD, I have experienced excellent performance in my investing from the late 1990s to October 2007."

Bob K., Hawaii, Mechanical Engineer

"Between the dot-com bust and 9/11, my portfolio lost nearly half its value over two years. Though I subscribed to the *Wall Street Journal* at the time, it did not prevent my loss. I subscribed to *Investor's Business Daily* and found it much more informative on investing. Soon, I found myself reading IBD rather than the *WSJ*. It was more to the point and was tailored to individual stocks rather than worldviews and mutual funds. I have never looked back. Using the knowledge I gained from IBD on reading stock charts and trends, I bought into stocks for triple-digit gains among many other double-digit-gain stocks. IBD has paid for itself many times over with what I have learned from CAN SLIM and other resources available. Thanks, IBD! I will be a lifetime subscriber."

Kenneth G., Michigan, Utility Planner

"I believe in results: I made my monthly salary in three days using IBD. I'm a believer! I've looked at several investing sources. IBD and Investors.com are the only ones that made me more money than I spent learning it."

Kent J., California, Manager

"I sold a business, and after a couple of years with GS money management, I decided that I must manage my money myself. It wasn't long before we realized that IBD is the only daily publication that sincerely wants to help people make money in the market. That's why we're so loyal to the paper. We don't look at any other sources of information of any kind because it only confuses the issue. It's tough to shut down those media inputs. IBD has been wonderful for us. It works very well, and every year we're doing better because we see the results in the portfolio. In our second year using IBD we had a 26% gain, and it's only gone up substantially since there."

Michael D., California, Retired

"In 2006 I used a number of newly acquired CAN SLIM skills to buy into Hansen Natural and to pyramid and force-feed my growing position to the point where I had nearly 80% invested in HANS. Following CAN SLIM principles, I sold my entire position May 11, 2006, for near perfect timing. This one trade made my year and enough to cover for lean years the following two years. I would not have traded with this success without using IBD."

Joseph S., Pennsylvania, Executive

“Investor’s Business Daily is one of the best things that has happened to our family from a financial point of view.”

Roger D., Iowa, Teacher

Tools That Work

“‘The Big Picture’ keeps me focused on proper interpretation of general market averages. I also use the ‘IBD 100’ for confirmation that stocks I might be interested in are seen in the same light by the experts at IBD. I like the entire B section: ‘Stocks on the Move’ shows where the action is; industry group rankings let me know where to focus research; the stock research tables grouped by leaders make it easy to see what stocks are leading. I could keep going. The A section is excellent for keeping up on important news. The paper is so well organized.”

Mark R., Washington, Individual Investor

“I love reading the IBD newspaper—‘The Big Picture,’ ‘IBD’s Top 10’ news stories, and many more. It keeps me focused on what’s happening with the stock market and the economy. While IBD provides a superior wealth of information for finding good stocks, this newspaper is also an excellent space- and time-saver. It makes it so easy to take anywhere I go. Thanks to the IBD staff for their great work.”

Paul C., Maryland, Investor

“The ‘IBD 100’ is the foundation of my portfolio. It provides a list of stocks that I assess from a fundamental and technical basis. The quality of the stocks maximizes the probability of a trade.”

Steve M., Colorado, Equity Trading Manager

“‘The Big Picture,’ ‘Investor’s Corner,’ ‘NYSE & NASDAQ Stocks in the News,’ along with the ‘Market Wrap’ and ‘Daily Stock Analysis’ videos, ‘Stock Checkup,’ and ‘IBD University’ at Investors.com, are the features I use the most to help me stay on top of the market, select strong stocks, and learn to become a better stock investor. All are invaluable.”

Alex J., California, Student

“I read ‘The Big Picture’ first because it is the starting point for getting a feel for how the market is going. Once you have that information, you can make informed decisions on how to proceed with investing decisions. IBD is the premier investing document that provides everything for everyone, from the beginning investor to the most advanced investor. Taking full advantage of all of the many features will give you the best chance of success.”

Cliff B., Texas, Retired U.S. Air Force

The Confidence to Win

“IBD changed my life in that it gave me full confidence as a self-directed investor, and it presented the right information that has allowed me to grow and preserve my portfolio. What began as an education blossomed into a passion, and this was the real life change for me.”

Mary L., Tennessee, Realtor

“I’m a beginning investor who knew nothing about the stock market. Through Bill O’Neil’s *How to Make Money in Stocks, 24 Essential Lessons*, and the excellent coverage, education, and tips provided in IBD and Investors.com, I find myself more knowledgeable than most people I know who’ve been investing for years.”

Kim P., California, Individual Investor

“William O’Neil enabled me to do something even my CPA was not able to do: master my finances.”

Mike H., Florida, CPA

“I got started in the market in 1990 after reading I believe it was your second edition, and what it did for me is truly unbelievable. You really explain every aspect of the market so well. I also have been a subscriber to *Investor’s Business Daily* since that year and spend two hours per day on it. Thanks for helping to make me secure in investments.”

Ruth B., California, Individual Investor

“Using *Investor’s Business Daily*—both the newspaper and Investors.com, along with Daily Graphs and my own research—I am extremely confident of continuing to make money in the markets.”

Daryl T., Texas, Computer Programmer

“IBD and Investors.com have been a tremendous teacher & tool for me. IBD is one of the few resources I’ve found that not only gives information in an understandable way but also includes instruction on deciphering information that makes sense. Thank you for taking the intimidation out of investing!”

Sherrie C., Nevada, Investor

“IBD and CAN SLIM empower me with the information I need to manage my money more successfully. I’m in charge of my money, so it’s important that I understand how to invest it. And IBD is so good for that. Knowledge is power, and that’s why I read IBD.”

Carol M., Oregon, Planning Commissioner

Oldies but Goodies

The third edition of *How to Make Money in Stocks* featured IBD readers who achieved investing results or shared how they learned to use the IBD and CAN SLIM system. We thought we should reprint a few of these comments in hopes they might provide helpful insights for you.

Labor Day, 2001

Dear Mr. William O'Neil and *Investor's Business Daily*,

As a huge enthusiast of *Investor's Business Daily* and all of your written material, I can't write enough explaining how much your works have changed my life.

I first came across *How to Make Money in Stocks* in the fall of 1997 through reading reviews of it on Amazon.com. I was living and teaching in Guatemala at the time, and was looking to get involved in investing and the stock market. Consequently, I ordered *How to Make Money in Stocks* and a few other books, but it was your book, based on historical research, that intrigued me the most. I reasoned that you had seen both great times and rough times in your over 40 years of trading, while most other books had research based only from the 1990s. In addition to that, you used both technical and fundamental analysis rather than concentrating on just one method. The other books I read advocated either one analysis or the other.

I was further convinced that your system of trading was for me when you wrote how David Ryan and Lee Freestone had won U.S. Investing Championships using the CAN SLIM system.

What complements *How to Make Money in Stocks* perfectly is *Investor's Business Daily*. I had clipped out the coupon in the back of your book for a free two-week subscription to IBD, and when I received the paper for the first time, the whole system made sense to me. Finding the CAN SLIM stocks was so much easier to do using IBD, and the paper had so many other great articles, including 'Leaders & Success,' 'The New America,' 'Stocks in the News,' and my favorite, 'Investor's Corner,' that further enhanced my insights into trading. I immediately subscribed to it, even though \$180 was a lot for me at the time. Then, even though the paper would arrive in Guatemala three days late each day, I could still use its valuable information for research.

I read everything I could in the paper and decided to use it in my profession of teaching. That year, as I was teaching English as a Second Language in Guatemala, I also taught one class of fifth-grade gifted and talented students.

I introduced them to IBD, and they ate it up. These students, and my other students later, especially loved the stock tables because each stock is graded like they are graded, using 1-99 and A through E or F. Students were always coming up to me and saying things like, 'Look at this one! It's got a 99, 99, and AAA.' I have even taught my students to look for cups with handles, and they have enjoyed the challenge of that, too.

I moved back to Denver in the summer of 1998 and continued using IBD both personally and professionally. I had the same success here, with many of the same student reactions as I did in Guatemala. Then, last year, during the 2000–2001 school year, I taught a sixth- through eighth-grade after-school business club. Using IBD, I helped my students participate in the *Denver Post* annual stock market competition. One team, a group of two Ethiopian boys and one boy from the Philippines, all of whom had only been in America for a year, won second prize in the state! In fact, the only problem I've had using IBD in my classroom is when these students fought over who got IBD's 'Your Weekly Review' section on Fridays.

As a result of this success utilizing IBD in my classroom, I have a lot of other ideas for using IBD in education. If you ever think about creating a curriculum outreach program, I'd love to share them with you. There is so much in IBD that would be great for schools!

As far as my own investing, I still read IBD daily and subscribe to Daily Graphs Online. I am more confident now and strongly feel that when this bear slowly turns itself into a bull, I will be able to find and buy, at the pivot point, the next Qualcomm, JDSU, or Qlogic. (The pivot point took me about three years to completely appreciate!) At first, I was the typical beginner with no discipline. I would cheat on the CAN SLIM rules, simply buying anywhere and anytime regardless of what the chart showed. I also bought Internet stocks simply because they were Internet stocks. And I tried many other methods looking for instant profit and success. All in all, during my first two years of investing, I 'nicked and dined' my account to very low points, dragging my ego down with it.

Finally, I disciplined myself and made a CAN SLIM checklist. I swore that I wouldn't violate any of the system's rules. As a result, my successes have increased. And even though the market during the last year and a half has been rough, I did make a few nice trades, such as with Techne, Skechers, International Gaming, and Direct Focus. I have read and reread Chapter 11 [When to Sell and Take Your Profit] in *How to Make Money in Stocks* about 20 times so that I can remain focused for the next rally. I'll be shooting for the stars like you did from 1962 to 1963.

In conclusion, I would also like to express my appreciation for your love and respect of America. I have taught and traveled in many countries, and it is easy to say that America isn't perfect, but I feel, as you do, that if you work hard in America, great things will come. My father came to America as a poor, young immigrant in 1950 and has built up a great mason business, all through hard work. He always told me that if you work hard and remain positive, you can achieve anything you want. I feel that you and IBD express this same sentiment every day. And believe it or not, I bought my father a subscription to IBD for his birthday, and now he loves it, quotes from it, and reads it every day!

Most importantly, however, I want to thank you for the great work you do and the great information you print daily. It is greatly appreciated!

Sincerely,

David C., Investor

I started studying the market in March 1999.

After six months with a broker and no results, I went to the library, found *Investor's Business Daily*, and decided to learn to invest on my own. I started last September with \$50K. When I sold everything in March after reading your latest book, I had \$174K. Made most of my money on cup-with-handle formations and reading your book, *How to Make Money in Stocks*. I am a minister and want to use the money to start churches here in Illinois. My goal is to start 13 churches in the next few years. Thanks so very much for sharing your strategy with others.

Dr. Larry R., Pastor

In addition to success stories, we also receive letters from readers that provide extraordinary insight. The following is from one of our readers whose background, as a civil engineer in the former Soviet Union, gave an interesting perspective to contrasting economic systems. We ended up creating a series of articles from this reader to share her insight.

Perspective of a Russian Immigrant (No. 4)

Svetlana Kunin

12/08/2009

I look at the people who support the transformation of America in disbelief: They are destroying the very land that gave them so much opportunity.

Groomed, well-fed and educated, comfortably living in a prosperous society, they need a mission to give meaning to their lives. These “fighters for the less-fortunate among us” glaze over the fact that hundreds of millions of people from around the world desperately try to come to this country for all it offers, regardless of their economic status, race, class, or gender.

Immigrants rightly see this country as the best place to obtain a decent life for themselves and their families.

When I immigrated to America in 1980, I was overwhelmed with the amount of food and goods available at any store, at the numerous charitable organizations helping the needy, and even the government programs that helped people to obtain necessary skills to find a job.

Later, I realized that the country was in the midst of a deep recession. Compared to where I came from, it seemed like the pinnacle of prosperity.

As a secular Soviet Jew, my first Christmas in America was amazing. The proud display of religious symbols was a celebration not only of the holiday, but of a population free to express their beliefs without fear of oppression.

I understand why at the beginning of the 20th century Jewish immigrants in America wrote many beautiful Christmas songs; these songs were born out of grateful hearts. Churches and synagogues coexist without issues. Nobody is forced to practice or not practice a religion.

Soon, however, I noticed darker aspects underlying life in America. Political correctness had seeped into everything like cancer. Under the pretense of multicultural diversity, suppression and intolerance of uniquely American traditions such as liberty, private property, and *e pluribus unum* (out of many, one), became not only acceptable, but necessary in supposedly enlightened society.

Under the pretext of helping the needy, liberals eliminate people's drive to better themselves and their families. Instead, they obsess about events of the past and exacerbate the victim mentality in the very people they claim to help.

The stranglehold of political correctness has only grown stronger. I see in today's governmental policies a replication of the very things I escaped from.

In the USSR, representatives of the Communist party—partorgs (literally: party organizers)—were ingrained into every aspect of civilian, official, and military life. These political organizers controlled public order by observing the behavior and speech of every citizen.

People who wanted a more secure and privileged life found it necessary to join the propaganda machine. In order to survive, citizens were silent out of fear of retaliation by the authorities.

Government-controlled medical care and poorly compensated medical personnel stimulated corruption at every level of service. People had to resort to bribery in order to get the help they needed, and underpaid medical personnel were open to the payouts.

Those who could not pay had to beg for help. The only hospitals comparable to American hospitals were in Moscow and a few other cities, where government officials were treated. In the rest of the country, medical care was substandard. This was the reality of free health care for everyone.

No one can dispute that America has issues with its medical system, and here too, some people struggle to get the help they need. But the solution to the problem is not more bureaucratic control. The quality of medical care will inevitably decline for everyone.

I came to this country in the middle of a recession, and I saw the economy revive and prosper when the government eased the tax burden on people and businesses. People were free to use their talents without the interference of central planning. Today the opposite is taking place, and we see the opposite results because central planning results in wasteful spending, corruption, and the suppression of initiative.

I am afraid these transformers of America are destroying the future of our children. I hope the free spirit of America triumphs.

• ACKNOWLEDGMENTS •

I want to recognize and express my thanks for the following dedicated people who assisted in this current edition. Wes Mann, IBD's editor, provided his insights and editing, Justin Nielsen helped significantly with the tables and charts, and my assistant Deirdre Abbott Casey worked with the many manuscript changes.

The following individuals made other key efforts in making the book possible: Andy Ansryan, Ates Arkun, Matt Galgani, Chris Gessel, Dayna Grund, Jonathan Hahn, Trang Ho, Brian Lawlor, Sarah Lawrence, Susan McKnight, Adrienne Merrick-Tagore, Anne Morein, Zarzand Papikyan, Sarah Schneider, Kathy Sherman, Tina Simpkins, Kate Stalter, Cuong Van, Diana Wada, Mike Webster, and Christina Wise.

I also want to thank Mary Glenn, Ruth Mannino, and their fine staff at McGraw-Hill.

• ABOUT THE AUTHOR •

William J. O'Neil is one of Wall Street's most seasoned and successful veterans. At age 30, he bought his own seat on the Big Board with profits made in the stock market and founded William O'Neil + Co., Inc., a leading institutional investment research organization based in Los Angeles. The firm's current clients are over 600 of the top institutional investment firms in the world. Mr. O'Neil is also the founder of *Investor's Business Daily* and its companion Web site, Investors.com.

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FOREWORD BY **WILLIAM J. O'NEIL**,
FOUNDER OF *INVESTOR'S BUSINESS DAILY*

How to Make Money in Stocks Success Stories

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Co-host of *How to Make Money in Stocks* Radio Show

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Congratulations to *Investor's Business Daily* on a quarter century of service to Americans. I confess that I mutter the phrase, "I wish I had written that!" more often reading IBDeditorials.com than at any other publication.

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Congratulations on your longevity achievement. Truly outstanding. To an investment adviser, news is stock in trade. I can always count on your concise summaries to convey the business day's chief events, and your graphics supplement this in a fine manner. Keep up the good work.

FRANK J., OHIO, INVESTING MANAGER

I have been an *IBD* reader since the beginning. After a lot of mistakes I eventually became a believer in the IBD – CAN SLIM method of investing. The best part is having a lot of cash at the bottom of a bear market. If that doesn't make one a believer, nothing will. Congratulations and keep up the great work!

RON E., NEW YORK, INDIVIDUAL INVESTOR

I have been reading, studying, and implementing the IBD methodology of stock analysis and selection since 1988 and have been a subscriber for much of that time. The IBD team has continued to provide a service to investors small and large with tools to beat the market across a broad spectrum of investment opportunities. Thank you for a quarter century of service.

MICHAEL G., ILLINOIS, INDIVIDUAL INVESTOR

How to Make Money in Stocks Success Stories

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How to Make Money in Stocks Success Stories

*New and Advanced Investors
Share Their Winning Secrets*

Amy Smith



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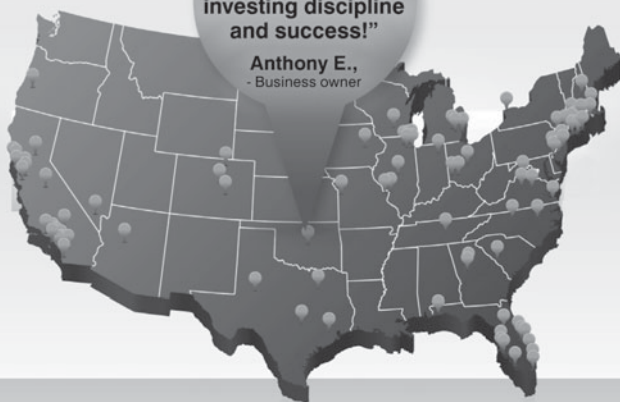
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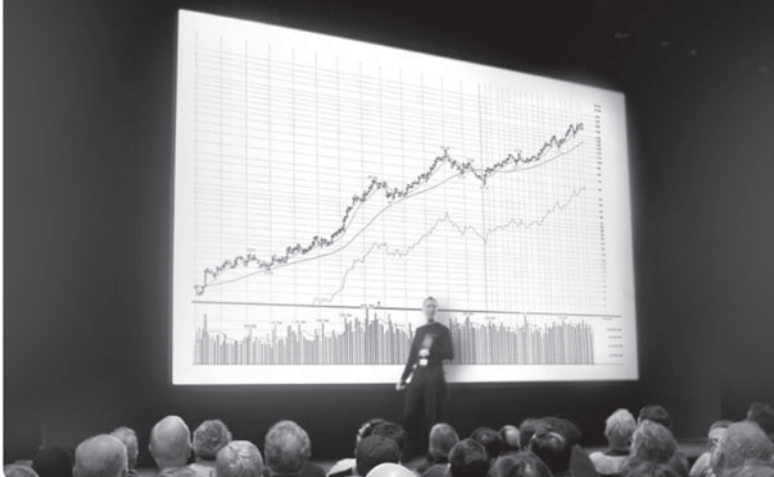
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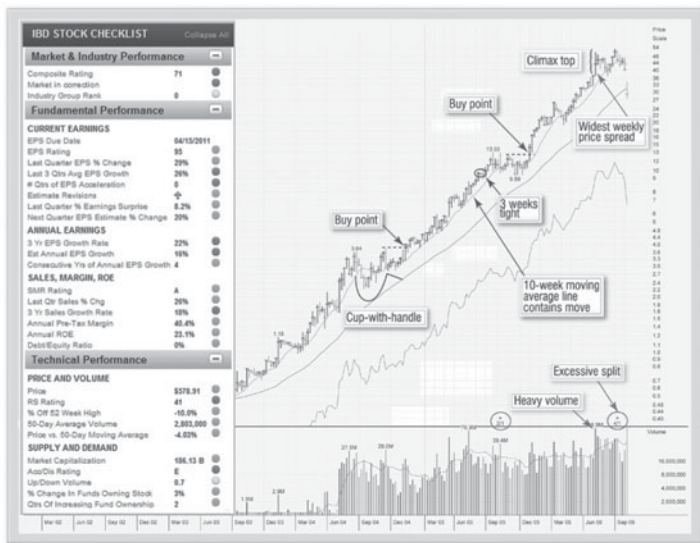
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• FOREWORD •

How to Make Money in Stocks Success Stories is treasure trove of success stories you should *read carefully*. Author Amy Smith has been investing for many years, saying that her discovery of *Investor's Business Daily* and the CAN SLIM Investing Strategy are what helped her learn how to invest so well.

I first met Amy many years ago at a large, local IBD Meetup event where I spoke. She was a member, and I recall after my presentation, she and others stayed behind to talk. I could tell Amy had figured out how the market works, and other members in this group were also very sharp.

The next time I met Amy was when an associate wanted to hire her and asked if I'd like to meet her. In the interview, she answered questions skillfully and was emphatic about how IBD and CAN SLIM were the keys to good investing. We hired her on the spot as Director of IBD Meetup Development. Years later, she's created a considerable number of new clubs and spoken to thousands of investors who shared their own experiences with Amy.

This book was a logical follow-up to my earlier book, *How to Make Money in Stocks*. In Amy's collection of Success Stories, she catalogs the investing journeys of everyday people as well as a few pros, all of whom achieved a great deal. And she likens the journey of an investor to that of a martial arts student learning the discipline and steps to the Black Belt, which is the highest honor. I found the book full of insights and ideas about what made investing work well for these individuals. Each person shared clues about getting started, developing winning routines, and how they learned to recognize their strengths and weaknesses. These are powerful insights, and most of these investors told Amy they felt investing was worth the time and effort—and that it had changed their lives.

I've no doubt if you read this book and scrutinize their approaches, you can benefit too. Amy and these individuals are living examples of what you can accomplish if you want it badly enough. And I'm convinced that you can do this. The information is ready for you to study and absorb, but getting started is up to you.

Remember, investing is not easy, but if you're determined to learn to make money in the market, then that determination and focus will be your winning edge. *But* if you've decided in the past, or even as you read this now, that it sounds like a lot of work and you're not sure? Then I think both Amy and I have earned the right to tell you: *You are missing out on one of the greatest chances to change the course of your life!* Sounds pretty dramatic, yes? Yet, if hundreds of thousands of individuals have made this system work, there's nothing holding you back but your own doubts or unwillingness to even try.

Maybe this book will lend the encouragement you need, as you read about a woman whose husband died and, shortly after, she lost her job. She is now independently wealthy. She had no background in investing at the start but took up the challenge and made it work. What Amy's interviews will show you is that many good investors started without experience—and not much money. Even some of the pros she talked to knew very little at first. You'll learn their approaches and how they overcame their mistakes and hesitations. You may recognize yourself among some of these people and realize that investing is worth pursuing.

I don't want you to feel that because I've invested for years that it sets me apart from you. I had virtually no experience when I began learning to invest—nor did Amy or many others. Investing is *not* an elite club, or something you cannot do. If you think that way, I believe you are dead wrong. Your biggest challenge will be your own doubts or hesitations. I hope you take up this challenge, promise yourself to stick with it through thick and thin, and remain determined and positive. Then it can work. After you read this book, see if you don't feel encouraged. I read it and felt hopeful for each one of you who wants to succeed. You can do this!

We're here to help you on your investing journey.

Wishing you the very best.

Sincerely,



William J. O'Neil
Chairman and Founder
Investor's Business Daily

• PREFACE •

*“Do not let circumstances control you.
You change your circumstances.”*

—JACKIE CHAN

Every story in this book proves Jackie Chan’s quote. You can control your circumstances in great ways and gain control of your life and your future. My own journey with investing has been amazing, and I’m glad every day that I stepped into a world that was entirely foreign to me.

I was a theater major in college and was a successful private fitness trainer for many years with no background in the stock market at all. One day, a client asked me about a supposedly hot new nutritional beverage. The client was also excited about the company as a possible stock investment. Not knowing anything about stocks or the market, I bought *Investor’s Business Daily* (IBD) to do a little research on the company.

When I was checking out this “hot stock tip,” I noticed an ad in the paper for a free workshop with IBD Chairman and Founder William J. O’Neil, so I decided to attend. Bill spoke about stocks and the market in a way that made sense to me. He talked about innovative companies that were producing new products or services that were in great demand and, as a result, had soaring earnings and sales. The information seemed logical and didn’t sound like a bunch of hype, so I began subscribing to the paper. I quickly realized how well the CAN SLIM Investing System worked (which you will learn about in the book) and what an incredible newspaper IBD was for finding winning stocks!

At that time, the newspaper was delivered in the evening to my home. I would look out the window every five minutes until I saw the delivery guy drop it on my driveway. I’d run out as soon as it was delivered and sit in bed circling stock candidates the way Bill taught us to in the free workshop that I had attended. It was almost unbelievable to me how good the newspaper was for finding winner after winner.

Investing can be a somewhat isolating endeavor however, so wanting to connect with other people that shared the same investing passion that I did, I joined Santa Monica IBD Meetup. I enjoyed the group so much that I wish I had joined years earlier. I met fellow investors who will be lifelong friends. We trade e-mails all the time regarding the market or leading stocks. Eventually, I began volunteering and helping at the meetings and became co-organizer of the group.

One night, to my great surprise, Bill O'Neil showed up. It was very exciting for me to meet one of my heroes in person. I got to know other people at IBD, and eventually Bill offered me a job. It has been a pleasure and a privilege working with Bill and my other terrific colleagues at IBD, all of whom do an outstanding job of bringing the top investing insights and stories to subscribers.

Part of my work at IBD includes heading up the Meetup Development Department. Along with another Meetup director, Tim Reazor, we have expanded the program across the United States as investors flock to the meetings. It has been extremely rewarding to see investors learn and profit as a result of the IBD Meetup program.

In coming across so many successful investors, it became clear that their stories needed to be shared. No matter what your background, education, job experience, or age, you can learn to invest successfully. I hope these stories will encourage, inspire, and motivate you.

Both of my children are black belts in Taekwondo, and I have taken many self-defense classes myself. Needless to say, I've spent countless hours in the dojo (martial arts training facility).

The tenets of martial arts training bear remarkable similarities to those of becoming a successful investor, so I have chosen to use analogies from the martial arts world to discuss investing.

I would like to thank everyone who contributed to this book for their time and willingness to share their stories about investing. Listening to their success stories was energizing and motivating. It is my hope that by reading this book, you will become excited about investing.

Whether you are just starting out or are a more seasoned investor, I believe these success stories will help you become a better investor.

My best wishes for stock market success,

Amy Smith

**For more information and
further details about Amy's book:**

www.investors.com/stocksuccessbook

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1

• CHAPTER •

Entering The Dojo: The Decision to Start Investing or to Achieve Greater Results

“Teachers open the door, but you must enter by yourself.”

—CHINESE PROVERB

The beginning martial artist enters the dojo with some trepidation and hesitancy, wondering what will be expected during the training. The black belt instructor enters the room preparing to teach and yells “Charyot!” (Attention!).

A new investor feels the same uncertainty. What will be required? Can I really learn to be a successful investor? And investors with more experience might wonder if they can improve their results. The answer is yes; absolutely: virtually everyone can learn to invest successfully as long as they are willing to follow a proven system and keep a simple set of rules.

“Nothing is impossible to a willing mind.”

—THE BOOKS OF HAN DYNASTY

You have a desire to improve your life and your financial situation. Congratulate yourself for taking the chance.

Whether your motivating factor is to take a vacation, to buy a home, to generate retirement income, to build a college fund for children or grandchildren, to do more with your own money, or a wish for complete financial independence, you can learn to invest successfully if you're willing to follow a proven investment strategy and keep some simple rules.

Mike Scott was laid off when defense industry cuts hit California and he needed to replace his income.

Calvin Shih got motivated to learn more about investing after watching his dad's stock account dwindle after the dot-com crash.

Carole Shontere wanted to stop the bleeding in her husband's 401(k).

At the age of 50, **Jerry Powell** was faced with a tough job reassignment and would be on the road 60% of the time.

"Aloha Mike" was disillusioned with the corporate grind.

Jim Taub was looking for retirement income.

Townsend Baldwin was wiped out financially in the dot-com crash while he was on a humanitarian mission in Argentina.

Kathleen Phillips needed to work from home when diagnosed with multiple sclerosis.

Gay Walsh's IRA accounts were losing money.

Anindo Majumdar wanted to quit his corporate job and spend more time with his family.

Katrina Guensch lost a significant amount of money that had been left to her by her father during the 2008 bear market.

Bharani was working as an IT professional and wanted to increase his income.

Brian Gonzales wanted to pay off his student loans.

Jeannie McGrew was frustrated watching an investment advisor lose money year after year with her husband's 401(k) and figured she could do a better job.

Ken Chin wanted to be financially independent.

Barbara James' husband died, she lost her job, and she needed an income.

“We are only bound by our limitations to believe.”

—MARK BISHOP, OKINAWAN KARATE INSTRUCTOR

Most people lose money in the market, but it definitely doesn't have to be that way.

Contrary to popular belief, you can time the market, or at least you can put the odds in your favor if you follow a few basic rules, the most important one being to follow the market's overall trend.

“Buy and hold” is an investing approach that historically has not worked very well. As a result of that type of investing strategy, many investors lost money in the bear market of 2007–2008, not only in their personal accounts but also in their IRAs. All too many baby boomers are sitting on investments that are simply underperforming their needs for retirement.

The gift that you have as an individual investor is that you can get in and out of the market with greater ease than the professional investor who may take months to fill a huge position in a single stock.

Investor's Business Daily® (IBD®) has research going back to 1880 to help guide investors through every type of market, whether bull or bear. There has also been an in-depth study of the market's biggest winners and the characteristics they had in common prior to making their big runs.

Don't be intimidated by a lack of knowledge or past failure with investing. Everyone starts somewhere, and even if you haven't succeeded in the past, it doesn't mean you can't succeed in the future. The truth is, most people lose money in the stock market because they have no strategy or system that they follow. Many investors buy stocks because they like the company, or someone gave them a hot tip, or the stock seems like a bargain because it has pulled back a lot in price.

It is the institutional investors that drive the money in the market. They are looking for companies that are making products that are in big demand.

We all know the story of Apple, one of the best examples of a company that has been completely innovative and created products that were in big demand from 2004 to 2012. Apple's innovations have produced skyrocketing earnings and sales that captured the attention of the institutional investors—the mutual funds, banks, pension funds, and hedge funds.

Finding these big stock market winners is not as hard as you might think. They appear in every bull market, cycle after cycle. You only need to look at history as your guide. You don't need insider information or a rela-

tive who works on Wall Street, and you don't have to take tips that you might hear on TV.

What if you could buy the highest quality merchandise that you can find, the true market winners that are the best the market has to offer? These are stocks that vastly outperform the major moving averages.

Get ready for an exciting and profitable journey in the stock market. The only requirements are the following:

- Set aside sufficient time to analyze the charts.
- Develop discipline.
- Follow a set of time-tested rules.
- Be willing to look at your mistakes and correct them.

Let's get started!

2

• CHAPTER •

White Belt: Understanding the Trend and Market Timing

*“He who knows when he can fight and when he cannot,
will be victorious.”*

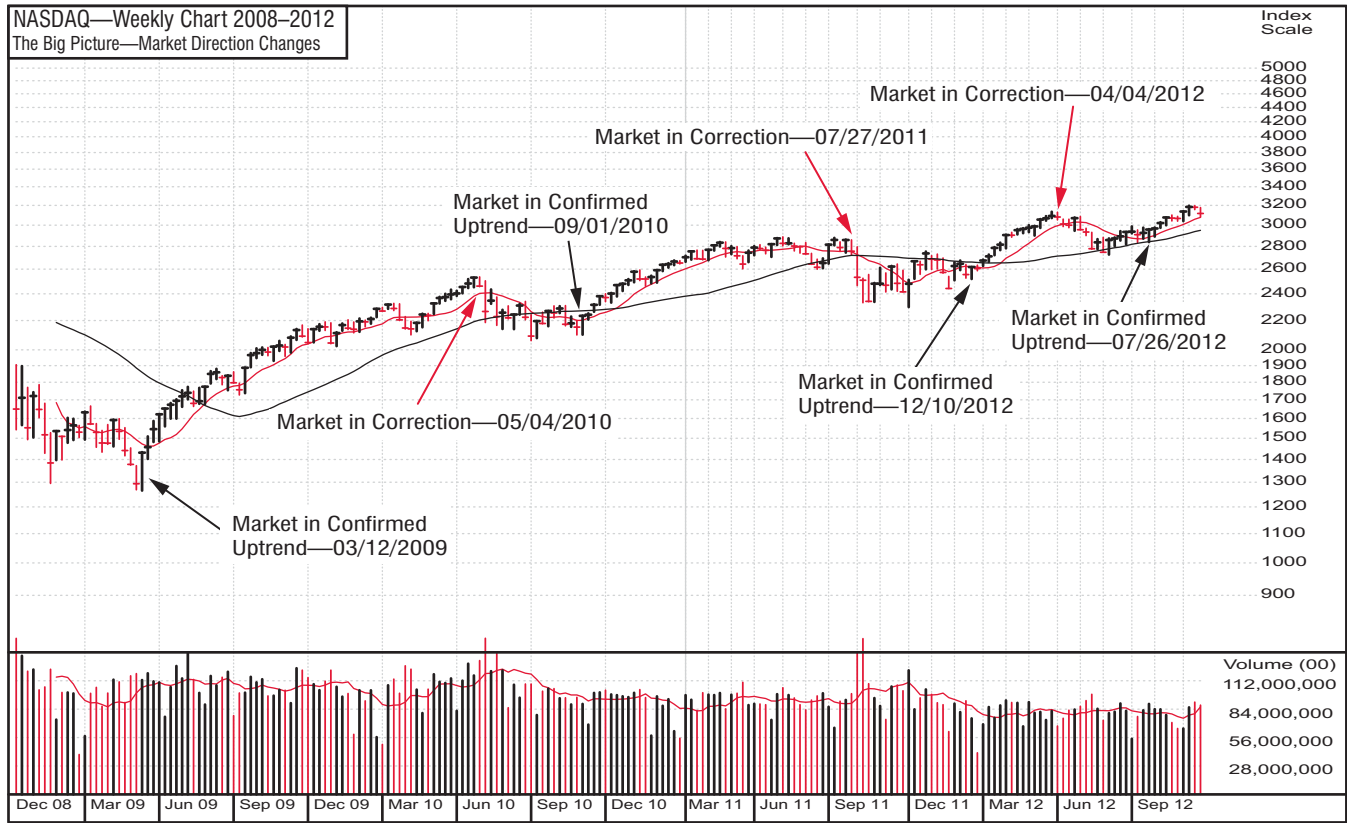
—SUN TZU

For a martial artist, bowing is a display of respect. An investor must bow to the market and respect the overall trend. Contrary to popular belief, you *can* time the stock market.

Every investor would like it if the stock market went up all the time, but that's not the way market cycles work. There are times to be in the market to maximize your gains, and there are times when you should step to the sidelines to avoid losses.

Understanding the Trend

It's important to understand whether the stock market is in an uptrend or a downtrend. Investing in an uptrending market is the most important factor for achieving gains.



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What Starts a New Uptrend

A follow-through day signals an important change in the general market direction from a downtrend to a new uptrend.

As an index rallies a few days off its lows, one of the major indexes will close the day higher 1.5% or more on bigger volume than the previous day. This signals that professional money is coming into the market, causing the indexes and leading stocks to rise.

While not all follow-through days work, no new uptrend has started without one. Stronger follow-through days will be accompanied by leading stocks breaking out of areas of price consolidations. That is why it is a good idea to always keep a watch list of stocks up to date during any correction and start a position in one of the stocks that is breaking out on the follow-through day.

How to Tell Whether a New Uptrend Has Begun

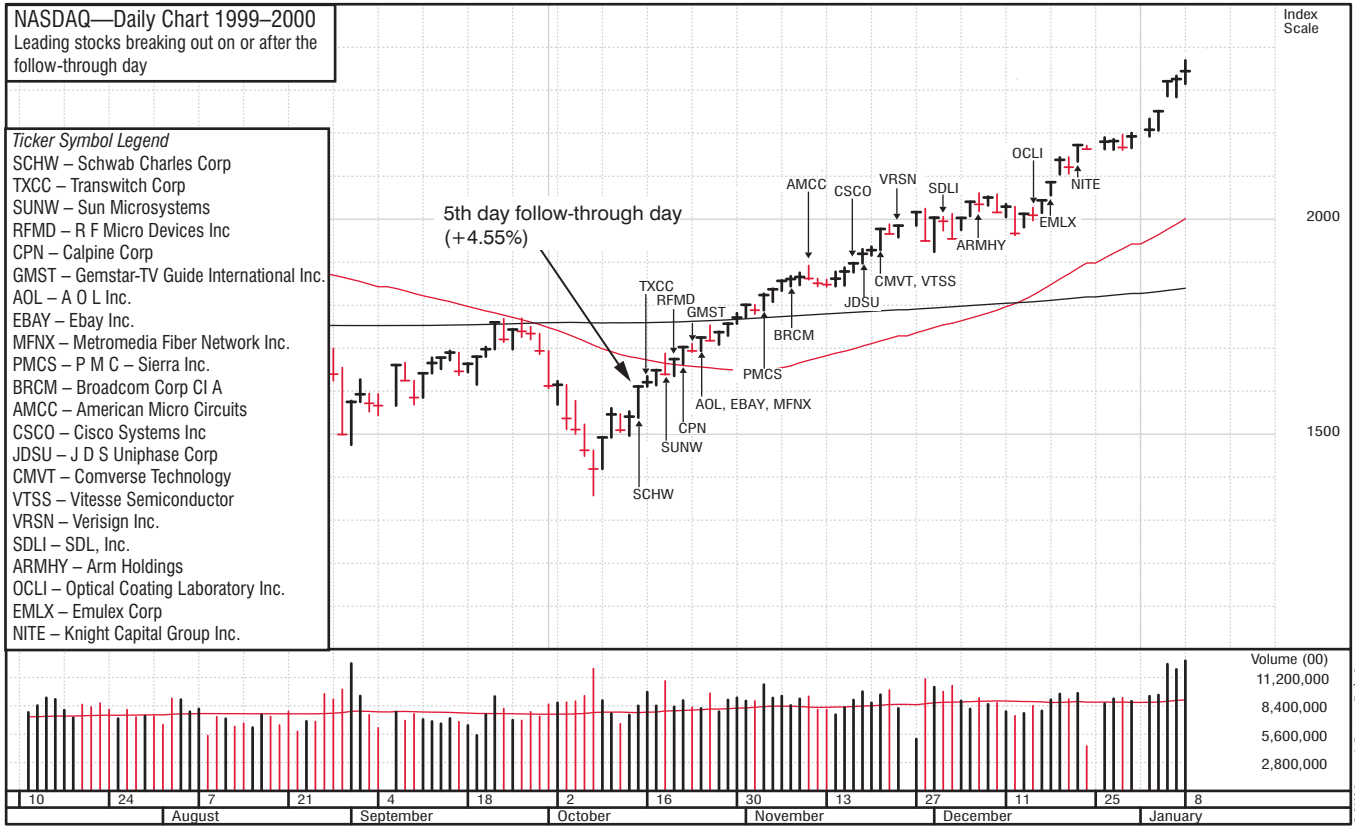
The *Big Picture* column in *Investor's Business Daily* (IBD) has a *Market Pulse* section that shows one of three stages:

1. Market in confirmed uptrend (it's a good time to be buying stocks)
2. Uptrend under pressure (time for caution, avoid new buys)
3. Market in correction (market is under selling pressure; consider locking in some gains on stocks that you own and avoid new buys)

MARKET PULSE
Tuesday's action: Market follows through
Current outlook: In confirmed uptrend
Leaders up in volume: Celgene ^{CELG} MasterCard ^{MA} Visa ^V
Leaders down in volume: Red Hat ^{RHT}

MARKET PULSE
Wednesday's action: Down in higher volume
Current outlook: Uptrend under pressure
Distribution days: 7 on NYSE composite, 5 on S&P 500, 3 on Nasdaq
Leaders up in volume: Dollar General ^{DG}
Leaders down in volume: Alexion ^{ALXN} Allot Communications ^{ALLT} InvenSense ^{INNV} Michael Kors ^{KORS} SolarWinds ^{SWI}

MARKET PULSE
Wednesday's action: Broad losses in higher trade
Current outlook: Market in correction
Distribution days: 8 on NYSE composite, 6 on S&P 500, 4 on Nasdaq
Leaders down in volume: Celgene ^{CELG} Polaris ^{PJ} Chipotle Mexican Grill ^{CMG} InvenSense ^{INNV} SolarWinds ^{SWI}



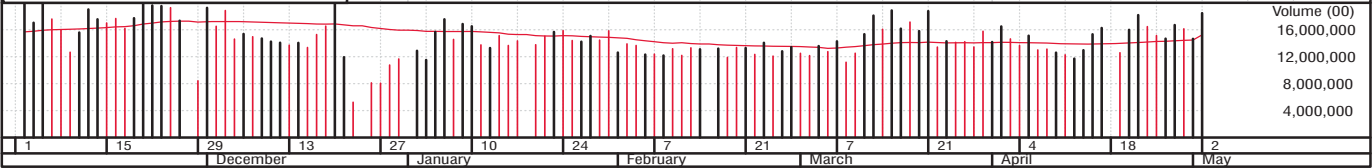
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NASDAQ—Daily Chart 2002–2003

Leading stocks breaking out before, on,
and after a follow-through day

Ticker Symbol Legend

SCHN – Schnitzer Steel Inds A
COH – Coach Inc.
OVTI – Omnivision Technologies
CECO – Career Education Corp
IGT – Intl Game Technology
NFLX – Netflix Inc.
YHOO – Yahoo! Inc.
MATK – Remark Media Inc.
TEVA – Teva Pharmaceutical Ads
UOPX – University of Phoenix Online
HOV – Hovnanian Enterprises A
JCOM – J 2 Global Inc.
NTES – Netease Inc Adr
UNTD – United Online Inc.
SOHU – Sohu.Com Inc
HITK – Hi Tech Pharmacal
ANSI – Advanced Neuromodulation Systems Inc.
DKS – Dicks Sporting Goods Inc.
CTX – Centex
AVID – Avid Technology Inc.
ASKJ – AskJeeves
HAR – Harman International Industries
SINA – Sina.com



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What Ends an Uptrend and Puts the Market into a Correction

A distribution day is a heavy day of selling on one of the major indexes. This heavy selling causes one of the indexes to close 0.2% lower on volume higher than that of the previous day. The CAN SLIM System focuses mainly on the S&P and the Nasdaq when counting distribution days.

IBD studies have shown that 5 or 6 days of distribution over a 4- to 5-week period are enough to turn a previously advancing market into decline, especially if distribution days start piling up quickly over a short period.

The increase in heavy selling is a signal to the individual investor that professionals are heading for the exits.

Since three out of four stocks follow the general market trend, it's best not to try and swim against the tide if the market is in a downtrend.

3

• CHAPTER •

Dojo Training: Following a Proven Strategy to Find Winning Stocks

“When the student is ready, the master will appear.”

—BUDDHIST PROVERB

The CAN SLIM® Investing System helps you find the market’s biggest winners by looking for the traits that they have in common prior to making their big moves.

What Do the Market’s Biggest Winners Have in Common?

In the 1960s, IBD Chairman and Founder William J. O’Neil asked this question as a young stock broker and studied all of the market’s biggest winners going back to 1950 (IBD’s ongoing study of the market’s best performing stocks now goes back to 1880). He also did not want to leave any performance details out, so even though computers were in their infancy, he hired programmers and statisticians to catalog stock data so he could see if it somehow made more sense. And it did. His visionary approach to apply-

ing computers to his research paid off big. He found seven traits that winning stocks had in common prior to making their big price moves. This became the basis for the CAN SLIM Investing System, which has helped both professional and individual investors for decades.

Each of the letters in CAN SLIM stands for a different trait that winning stocks have in common.

C Current quarterly earnings. Minimum of 25% increase in the most recent quarter. Many of the market's biggest leaders will have earnings increases in the triple digits.

A Annual earnings. Rate of increase at least 25%, the higher the better.

N New (new products or services, new management, new highs). Innovative companies making new price highs indicating institutional buying.

S Supply and demand. A product or service that is in big demand by the public.

L Leadership. Stocks at the top in their industry group with earnings, sales, return on equity, and price action.

I Institutional support. Mutual funds, hedge funds, pension funds, banks. The professional money is what will drive a stock's price higher.

M Market direction. Buying leading stocks with top fundamentals in an uptrending market and selling stocks when the market goes into a correction.

• KEY POINTS •

- The biggest winners will have the seven CAN SLIM traits.
- Buy stocks in an uptrending market.

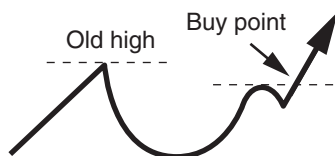
When Is the Right Time to Buy Stocks?

Stocks form chart bases or areas of price consolidation. When they come out of these consolidations on trading volume that is 40% higher than average, we refer to it as a breakout, and this is when a stock should be bought. Buying a stock as it is breaking out of a base pattern puts the odds in your

favor. Market history shows that stocks vault out of these areas of consolidation before moving even higher. But buying a stock that is extended in price from a proper base makes the trade more risky since the stock may pull back and can shake you out of a position.

There are three main base patterns that we look for in CAN SLIM Investing.

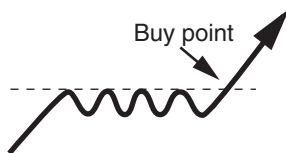
1. The most common base is the **cup-with-handle** pattern. It looks like a tea cup with a handle.



2. The **double bottom base** looks like a W with the exception that the right part of the W undercuts, or drifts down below, the left side of the W.



3. The **flat base** moves sideways in a tight range as the stock digests a previous move up.



Buying stocks just as they come out of bases or areas of consolidation increases your odds of success. Look for volume that is 40% above average on the breakout.

Some secondary buy points include: (1) A three-weeks-tight pattern (where a stock closes three weeks in a tight range with less than a 1% difference in closing price during that time). (2) A stock may be bought or

added to the first or second pullback to the 10-week moving average line on low volume. The low volume shows that institutions are holding onto their positions and not selling heavily.

Base Stages

As a stock is being bought and advances, it forms a series of bases, or areas of price consolidations along the way. Very few stocks move straight up from their first breakout. Most stocks stop and take a breather before moving higher.

We count these bases as first stage, second stage, third stage, and so on. The reason we count base stages is because IBD market studies have shown that earlier stage bases tend to be more successful than later stage bases. By the time a stock has made a big move and is in a third, fourth, or even fifth stage base, it's too obvious, most institutions have made big money in the stock and are ready to lock in profits and sell.

There are exceptions to the rule, and some stocks do continue to move higher in later stage bases, but you want to put the odds in your favor.

Netflix is an example of a stock that formed a series of bases along its move upward.

Look for stocks that are in earlier stage bases.

A Simple Routine for Putting It All Together

To Determine the Market Trend:

1. Check the *Market Pulse* found in *The Big Picture* column of IBD to find the current market trend.
2. Watch the *Market Wrap* video every day to stay in touch with what happened in the market as well as the action of leading stocks at <http://investors.com/IBDTV>.

MARKET PULSE

Thursday's action:
Down in lower volume

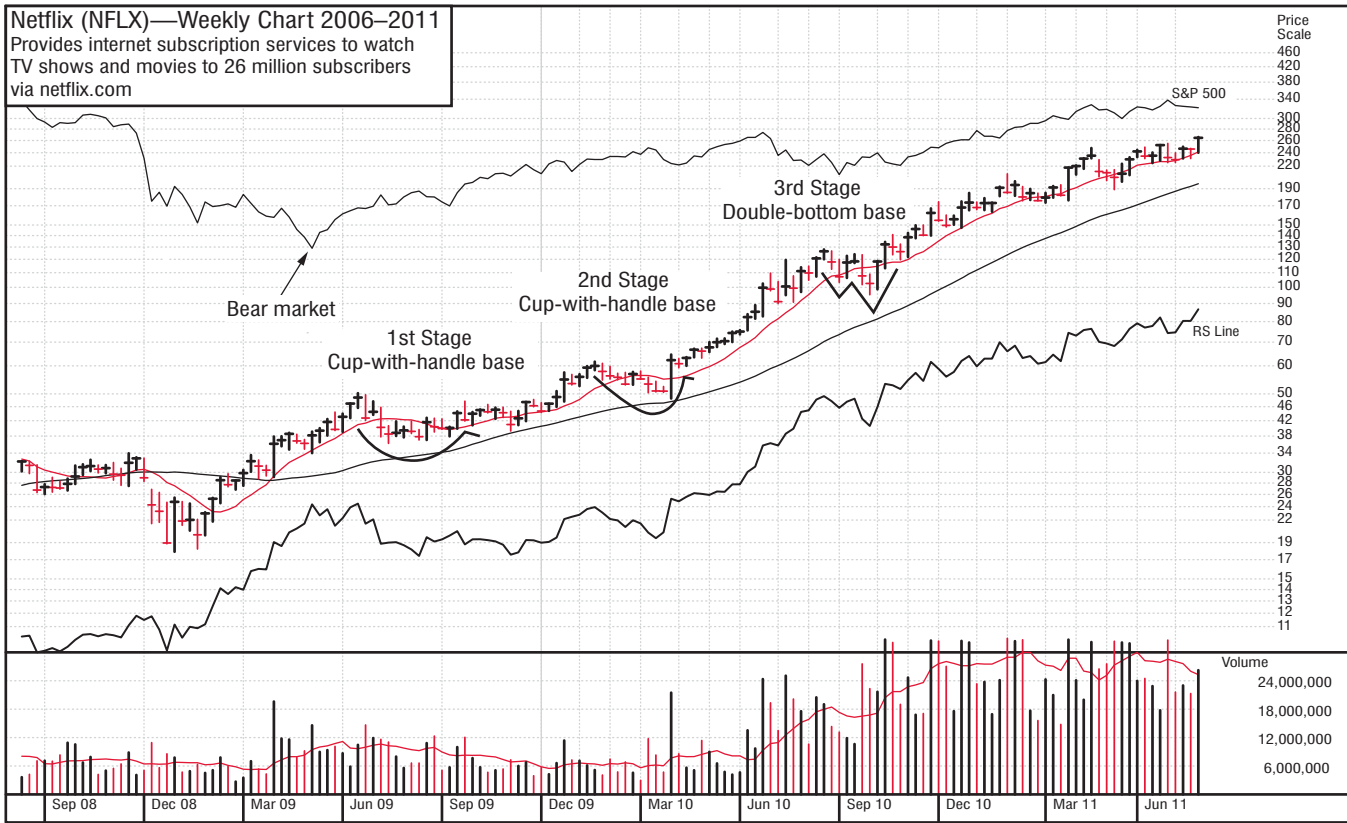
Current outlook:
Confirmed uptrend

Distribution days:
2 for Nasdaq and S&P 500,
1 for NYSE composite

Leaders up in volume:
Questcor^{QCOR}
Sociedad Quimica^{SQM}

Leaders down in volume:
Union Pacific^{UNP}
Canadian Nat'l Railway^{CNI}
Kansas City Southern^{KSU}
IPG Photonics^{IPGP}

Netflix (NFLX)—Weekly Chart 2006–2011
 Provides internet subscription services to watch TV shows and movies to 26 million subscribers via netflix.com



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Now Playing

► IBD MARKET WRAP - 9/13/2012
Posted: Sep 13, 2012 3:13 min
Stock surged Thursday after the Fed announced another round of stimulus.

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- HOW TO MAKE MONEY IN STOCKS RADIO SHOW: SEPTEMBER 29, 2012
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What benchmark line helps you see if it's time to buy, sell or hold? And tips on keeping your watch list manageable. Notes at investors.com/radioshow.
- IBD MARKET WRAP - 09/28/12
Posted: Sep 28, 2012 2:42 min
The major indexes fell Friday as the market rounded out the third quarter.
- DAILY STOCK ANALYSIS - CHICO'S
Posted: Sep 28, 2012 4:45 min
Chico's Shows Why It's Always Fashionable To Have A Game Plan For Your Stocks

To Find Leading Stocks:

1. Look at the *IBD 50* in the Monday and Wednesday editions of the paper.
2. Read underneath the mini charts to identify a proper buy point in a stock's base pattern.



IBD 50

SMARTS ELECTSM COMPANIES BY INDUSTRY

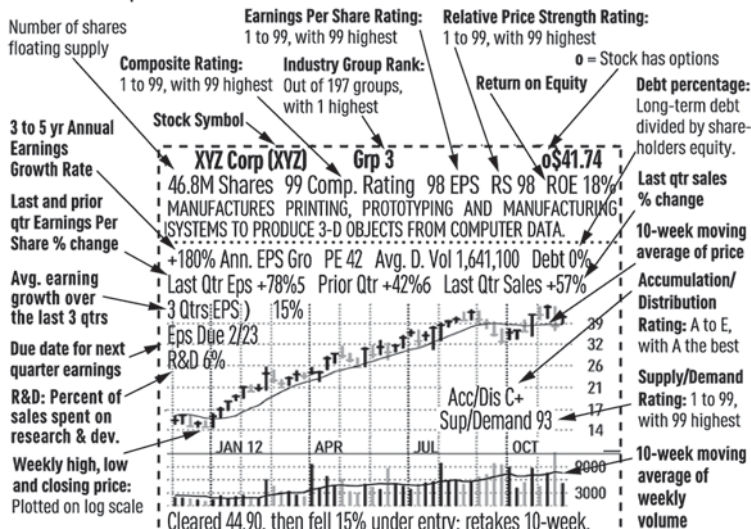
Rank	Company	Price	1Y %	3Y %	5Y %	10Y %	20Y %	30Y %	40Y %	50Y %	60Y %	70Y %	80Y %	90Y %	100Y %
COMPANIES 1-15															
1	SolarWinds Inc	59.70	99.99	98	-20	+50	0	+40	35	52	7				
► IT software firm adding new products through acquisitions.															
2	Michael Kors Ltd	53.59	99.99	97	+40	+142	+52	+71	54	70	34				
► High-end fashion at moderate prices helps Michael Kors grow.															
3	Mellanox Tech	101.4	99.99	99	+249	+247	+245	+111	13	18	33				
► Cloud computing. Big Data driving growth for its efficient connectors.															
4	Alexion Pharma	110.5	99.99	93	+36	+42	+27	+48	27	34	4				
► Focus on rare diseases yielding strong growth for drugmaker.															
5	Apple Inc	691.3	98.99	93	+59	+20	+23	+23	42	31	0				
► Seeks to maintain lead in personal technology as it launches iPhone 5.															
6	Sturm Ruger & Co	48.72	97.99	92	+52	+43	+43	+50	22	19	7				
► Company rides trend: Firearm sales in U.S. rising sharply since 2004.															
7	Alipha Tech	38.22	98.97	95	+25	+70	+7	+21	18	21	7				
► Maker of Invitae's clear braces expands into new markets like China.															
8	Texas Cap Bancorp	48.59	97.99	95	+50	+73	+38	+27	13	33	5				
► Independent lending teams, strong Texas economy boost performance.															
9	Francesca's Hldgs	31.64	95.99	92	+70	+87	+50	+49	..	20	23				
► Operates 249 apparel boutiques for fashion-conscious young women.															
10	Catamaran Corp	94.97	98.99	90	+33	+29	+7	+40	17	3	1				
► Used boats since '88 to shift to pharmacy, beneficial business model.															
11	TransDigm Group	145.4	97.99	90	+49	+55	+21	+42	34	29	4				
► Aerospace firm is sole provider of many of the parts it makes.															
12	Web.com Group	18.20	99.97	95	+48	+44	+34	+134	19	17	13				
► To benefit from mobile ads and social media for small businesses.															
13	CNC Holdings Inc	40.23	95.98	91	+48	+59	+35	+19	20	12	0				
► Dominant in sports nutrition; young demographics favorable.															
14	Lululemon Athletica	77.99	98.99	90	+42	+31	+33	+33	37	28	9				
► Fabric quality, operational prowess are form's strengths.															
15	Grand Canyon Edu	23.57	97.96	92	+24	+21	+17	+16	35	19	25				

INVESTOR'S BUSINESS DAILY



How To Read IBD Stock Charts

A brief explanation of what the numbers mean



IBD Stock Research Tool

MARKET DIRECTION

FIND STOCKS

EVALUATE STOCKS

TRACK STOCKS

Stocks on the Move

↑

↓

Add to My Routine

Watch Video >>

Stocks On The Move

Stocks being BOUGHT heavily by institutional investors.

Click icons for analysis. Learn More

Symbol	Company	Price	Price Chg.	Price % Chg.	Volume % Chg.	IBD Tools
TWTC	T W Telecom Inc	27.36	1.27 ↑	4.87% ↑	427%	
PATK	Patrick Industries Inc	18.28	2.81 ↑	18.16% ↑	427%	
NSM	Nationstar Mtg Hldgs Inc	34.45	1.27 ↑	3.83% ↑	229%	
HCSG	Healthcare Svcs Group	23.76	0.90 ↑	3.94% ↑	145%	
WST	West Pharmaceutical Svcs	53.91	0.84 ↑	1.58% ↑	128%	

Expand

View All >>

Real time prices by BATS. Volume delayed. Last Update: 10/01/2012 03:30 PM EST



Continue Your Education: Join a Free IBD Meetup Group

IBD Meetups are the fastest growing financial clubs in the United States. The reason for this is the success many members have had as a result of joining these groups, which meet once a month to discuss the CAN SLIM Investing System.

At a typical meeting, groups will discuss the current market trend, leading stocks, and how to build a watch list. They also go over a lesson designed by IBD Chairman and Founder Bill O’Neil, and ask questions. More seasoned investors help newer investors learn the system and how to succeed.

Katrina Guensch lives in an area that doesn’t have an IBD Meetup Group, so she participates in one that has online monthly webinars: the Chicago/Naperville IBD Meetup. She says, “The group has detailed meetings that have really helped me learn.” Through the webinars, she has met other investors to e-mail and discuss the current market and leading stocks.

Gay Walsh is a TV writer and had a desire to do more with her money, so she joined several IBD Meetup Groups in the Southern California area and found that attending so many increased her learning curve. She said, “Watching other people read charts was really helpful. A writer’s life can be up and down; I wanted to establish security for retirement. IBD Meetups have been a great resource for me.”

Carol Shontere says, “I have attended every single Thousand Oaks Meetup since June 2010. I have been blessed to find the best of the best with this group, including leadership from Mike Scott and Jerry Samet, and I have learned so much.”

Prabin Bishoyi is a senior software engineer who works for IBD. He sends out a newsletter to his group after each meeting, summarizing what was discussed as well as what stocks were analyzed from the group’s watch list.

As a leader, he engages the group with quizzes to cement key learning points in between meetings. He also has his group participate in creating a mock portfolio to see what kind of gains the group could generate from stocks that were discussed at the monthly meetings. Prabin says, “I am a continual student of the market and work hard so I can help my Meetup group members find success with IBD.”

Dennis Wilburn is an IBD Meetup leader from the Bay Area Money Makers, or BAMM for short. The group is “dedicated to technical analysis and, as a group working together, to achieve financial freedom by following CAN SLIM trading techniques.” The group first discusses the current trend, builds a watch list of superior growth stocks, and goes over proper entry points and position size as well as exit points, primarily using the *IBD 50*. One of Dennis’ most quotable statements is to “clarify and simplify so you multiply.” Having studied many different investing methodologies, he has “found the *IBD 50* to be a treasure trove of the market’s best performing stocks. This is where the big fish hang out. If you apply strict trading strategies and follow the overall market trend, you can do exceptionally well. That’s because the *IBD 50* stocks have to pass stringent criteria before making the list.”

Norm Langout is 80 years young and the IBD Meetup leader from Santa Monica, California. This was one of the first IBD Meetup Groups in the country, which Norm started at a Starbucks before moving to a Coco’s in 2003. Norm believes strongly in volunteering and doing community work to help other people. He also thought that by starting an IBD Meetup Group, he would find other investors with whom he could discuss the market and stocks and thought “we could learn from each other.” Norm has been a good mentor and has spawned several IBD Meetup leaders that originally started with Santa Monica IBD Meetup, including Mike Scott, the Thousand Oaks IBD Meetup leader; John Mackel, the Pasadena IBD Meetup leader; Sherman Neff and Louis Gabriel, the leaders from the Sherman Oaks IBD Meetup Group; and Jerry Samet, who helps teach at several IBD Meetup Groups.

Ted Leplat has taught over 250 IBD Meetup Groups across the country as an IBD national speaker and educator. He says, “Investing is the greatest opportunity, and everyone can learn to profit from the market.” From his vast teaching experience, Ted realizes that most people are short on time, so Ted has a simple routine that he teaches to the Meetup groups:

1. First, Ted goes to *The Big Picture* column to determine the overall trend. He makes note of stocks that are up on volume from the *Market Pulse* and starts a watch list.

MARKET PULSE

Wednesday's action:
Small gains in higher trade

Current outlook:
Confirmed uptrend

Distribution days:
2 for Nasdaq and S&P 500,
1 for NYSE composite

Leaders up in volume:
 Sherwin-Williams^{SHW}
 Impax^{IPXL} Qihoo^{QIHU}
 Polaris^{POL} Generac^{GNRC}
 Dick's Sporting Goods^{DKS}

Leaders down in volume:
 Questcor^{QCOR}

2. Next, Ted takes the stocks that he found up on volume from the *Market Pulse* and looks for the stock that is highest ranked in the *Timesaver Table*. This provides one new stock to add to a watch list every day.

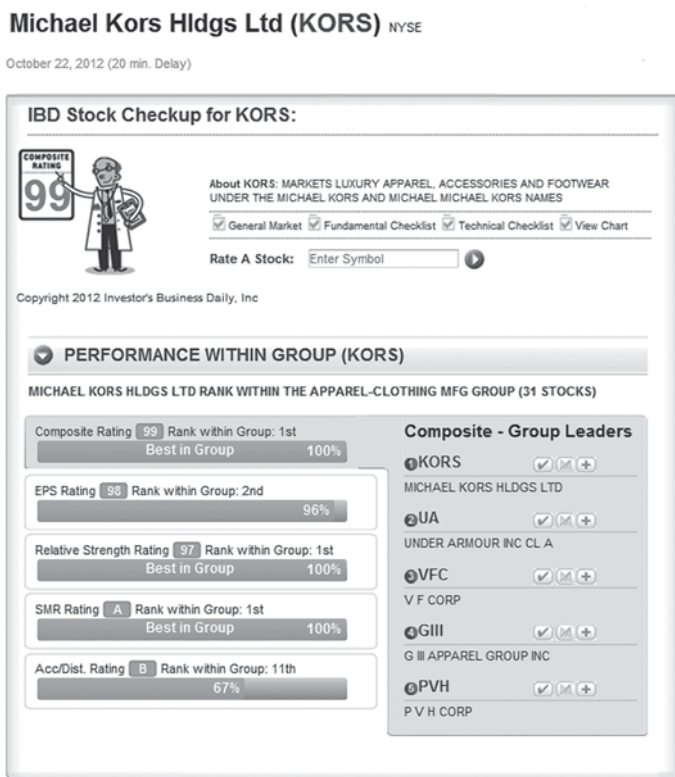
The SmartSelect® Composite Rating combines all 5 SmartSelect® Ratings into one easy-to-use rating. More weight is placed on EPS and RS Rating, and the stock's percent off its 52-week high is also included in the formula.

IBD TimeSaver Tables

Summary of key price action for NYSE & Nasdaq highest-rated stocks, a quick and easy snapshot for busy investors. *Italicized* stocks have 80 or higher EPS and Relative Price Strength Ratings and were IPOs in the past 15 years. Sorted by Composite Rating, IBD's single most useful fundamental & technical gauge.

SMARTSELECT® COMPOSITE RATING										SMARTSELECT® COMPOSITE RATING												
EARNINGS PER SHARE										EARNINGS PER SHARE												
RELATIVE PRICE STRENGTH										RELATIVE PRICE STRENGTH												
INDUSTRY GROUP										INDUSTRY GROUP												
SALES-PROFIT MARGINS-ROE										SALES-PROFIT MARGINS-ROE												
ACCUMULATION/DISTRIBUTION										ACCUMULATION/DISTRIBUTION												
52-wk Stock & High	Symbol	Close	Price	Chg	Vol	Vol	Chg	1000	52-wk Stock & High	Symbol	Close	Price	Chg	Vol	Vol	Chg	1000					
STOCKS UP										STOCKS DOWN												
99	99	98	A-A	C-NH	SolarWd	SWI	59.70	+1.23	-19	938	99	97	99	A-A	C-120	Mellanox	MNXX	101.4	-2.63	-8	1.2m	
99	97	A-A	A-NH	WaltonMgt	WAC	37.10	+1.13	-11	236	98	93	95	A-C	B-212	Equinix	EQIX	195.3	-5.22	+40	1.4m		
99	95	A-B	B-NH	LibraHlt	LAD	32.69	+1.52	-33	340	98	91	84	A-A	A-85.3	Amgen	AMGN	81.36	-1.97	+71	7.4m		
99	95	A-A	A-NH	RadSpace	RAX	65.83	+1.61	-24	1.4m	97	98	74	A	B-29.0	Realpage	RP	24.13	-1.88	+413	1.6m		
99	94	A-A	B-NH	Av Methods	ARM	118.1	+1.66	-35	88	97	97	86	C	A-B-45.9	WestDgll	rWDC	41.06	-1.52	+142	11m		
99	94	A	B-NH	MedSolut	M	62.86	+1.58	-2	679	96	89	84	B-A	A-NH	WestMed	WHS	116.2	-1.54	+31	307		
99	94	A-A	B-NH	AlkermPhar	ALT	40.66	+1.72	+45	47	94	94	81	C-A	B-61.1	ValePharm	VXX	56.37	-2.27	+124	4.1m		
99	93	A-A	A-NH	AlexionPhr	ALXN	110.5	+1.01	-9	1.1m	91	84	89	C-A	B-97.4	AthenaHlt	ATHN	90.47	-2.03	-32	302		
99	94	A-A	B-104	MercadLL	MEU	88.57	+4.07	-63	1.0m	91	83	91	B-B	A-NH	AdmPrvd	PJD	94.66	-1.81	+3	6		
99	98	99	B	B-NH	Lumbrt	LL	53.73	+2.99	+49	940	87	93	83	C-A	C-160	NovoNdrk	rNVO	153.5	-2.21	+109	673	
99	98	93	A	B-NH	United	UWD	123.2	+3.76	+25	3.2m	86	88	88	81	B	C-A-64.5	CBRL	CBRL	64.13	-2.04	+89	245
99	98	86	A	A-NH	CardinalFnl	CFNL	14.09	+0.03	+46	87	85	90	55	A-A	B-73.4	Hershey	HSY	70.09	-1.94	+79	1.6m	
99	98	81	A-A	A-NH	ESTMidstr	EDM	28.94	+1.29	+4	143	85	47	93	A	C-B-NH	Zillow	Z	42.72	-1.55	+102	1.7m	
99	96	95	A-A	B-NH	NetScout	NTCT	26.30	+1.10	-32	147	79	99	17	B	A-A-442	Chipotle	rCMG	336.5	-4.35	-9	879	
99	96	90	A-A	A-NH	ruet1	rRUE	33.58	+1.76	+22	772	77	96	72	B	B-75.9	Allergiant	ALGT	64.49	-1.64	+66	227	
99	95	96	A	A-NH	BOYHldy	BOH	26.37	+1.10	+173	155	73	5	99	A-B	B-70.5	Pharmdy	PCYC	62.46	-3.17	+98	1.0m	
99	95	95	A-A	B-NH	ixCaplth	TCM	48.57	+1.93	+37	546	70	32	99	A-B	C-113	Medivation	MDVN	108.4	-1.75	+20	80	
99	95	80	A	A-NH	Google	GOOG	789.7	+3.64	+132	1.4m	67	80	C	D-A-30.0	AmgenPhar	AMP	22.73	-1.82	+56	126		
99	90	77	A-B	A-NH	IPCm	IPCM	48.07	+1.58	+80	192	62	47	80	C-B	D-92.0	CymSABSP	SBS	78.19	-2.77	+126	613	
99	85	96	A-C	A-NH	CapitalStg	CSU	13.44	+1.39	+10	136	54	26	C-A	D-74.9	SprintAdns	SAVS	16.58	-3.08	+710	5.2m		
99	85	92	A-A	B-NH	afay	AFAY	49.97	+1.10	+77	14m	51	58	B-E	A-74.9	SenecaB	SENB	27.28	-2.17	+66	1		
99	79	93	A	B-106	UnitedShw	ULTI	100.4	+2.33	+25	204	49	37	55	C-B	B-284	Seabrd	SEB	27.29	-2.94	+50	0.9	

3. Then Ted takes investors to Stock Checkup® on Investors.com as a quick way to check a stock's strength in its industry group, earnings, sales, and other key fundamental data.



4. Finally, Ted consults a chart to see if the stock is setting up in a base pattern.

On the weekend, investors can read other IBD features to validate their picks during the week.

“The person with more time can do this routine with as many of the stocks in the *Market Pulse* as they want to,” says Ted.

Rao N. says, “I have learned a lot about CAN SLIM and the importance of a routine from Ted Leplat and the IBD Meetups.”

Join a free IBD Meetup Group at <http://www.investors.com/Meetup>.



Belt Promotion: One Stock Victory at a Time

“The time to strike is when the opportunity presents itself.”

—SIXTH CODE OF ISSHIN-RYU KARATE

The various martial arts forms use belt colors as a way of showing a student’s progression. Skills and knowledge are tested along with focus and concentration before a higher level can be achieved. Each promotion leads the martial artist to a deeper level of competency and understanding of the art form.

Investors sharpen their skills with each successful stock trade that they make, while staying steadfast to their rules.

Using IBD Features to Find Winning Stocks

IBD 50

The *IBD 50* is a proprietary list of the 50 top-ranked companies, published every Monday and Wednesday in *Investor’s Business Daily*. Companies are

ranked based on superior earnings, strong price performance, and leadership within their respective industries.

Stephen Cole

Stephen is a busy lawyer and an IBD Meetup leader in Sacramento, California. His weekend routine includes going through the *IBD 50*. He looks for stocks that are in first or second stage bases, with accelerating earnings 25% or greater, and a return on equity of at least 17%. (Return on equity measures how efficient a company is with its money.) Stephen builds a watch list by looking at the mini chart and the description below each one that describes a potential buy point. He sets an alert in his brokerage account that lets him know if a stock is nearing that price.

Stephen bought Transdigm Group in April and had gains of 14% through the end of September 2012.

• KEY POINTS •

- Look for stocks in the *IBD 50* that are in first or second stage bases.
- Stocks should have quarterly earnings of 25% or greater.
- Return on equity should be at least 17%.
- The description below the *IBD 50* mini chart will help identify a potential buy point.

Stuart Auvian

Stuart is the Meetup leader for the Marin County IBD group located in Northern California. He emphasizes to his group the importance of buying at least one stock when the market issues a follow-through day. “This puts you in the right place psychologically because you’re in the game, rather than trying to play catch-up if you get into the market late after a follow-through day,” he says. To build his watch list, Stuart pulls four or five stocks from the *IBD 50* that have top fundamentals. Stuart was successful with Alexion Pharmaceuticals, which had earnings growth of 48% and sales growth of 44%. Stuart bought the stock in December 2011 and sold on March 12 for a 20% gain.

• KEY POINTS •

- Buy at least one stock if there is a follow-through day.
- Build a watch list from stocks in the *IBD 50* that have top fundamentals.

Ted Staub

Ted is a retired executive from the pharmaceutical industry who lives in Florida. He had traveled the world for work and had little time to trade but always had an interest in the market. Before he started reading IBD and following the CAN SLIM principles, he thought that stocks that were going down in price might be a bargain. Through reading IBD, he learned that cheap stocks are cheap for a reason and began to look for stocks with great earnings that were basing or pulling back to the 10-week line when looking for entry points. His first winner was Web.com Group. The stock started moving up on heavier volume in June and Ted bought it. In July, Ted sold Web.com and locked in a gain of 25%, his first winner. He said that he was a little hesitant in the beginning, but “this first victory gave me faith in the CAN SLIM System.”

• KEY POINT •

- Look for stocks in the *IBD 50* that have big earnings that are basing or pulling back to the 10-week line in low volume, showing that institutions are still holding onto shares.

Ashish Dave

Ashish got started in investing in 1996. At that time, he was a young engineer and noticed his boss would put IBD in the recycling bin after he finished reading it. Ashish was interested in the market, so he pulled the paper out of the bin. He found that IBD was an “easy way to find great stocks.” His interest led him to read *How to Make Money in Stocks* and to attend several IBD educational workshops. Ashish doesn’t buy a stock unless it shows up on the *IBD 50* because he has found that a stock has a greater probability of succeeding if it shows up on this list. Ashish focuses mainly on the top 25

names. He prefers stocks that have low debt, a return on equity above 35%, and a relative strength line that is making new highs. (A relative strength line compares a stock's performance to that of the S&P.) A stock that Ashish found using these strong fundamentals was SolarWinds in October 2011. Through mid-September 2012, he had gains of 122%.

• KEY POINTS •

- Concentrate on the top 25 names in the *IBD 50*.
- Look for low debt, a high return on equity, and a relative strength line making new highs.

Stocks on the Move

Bharani Ramamoothi

Bharani is an IT professional with little time during the trading day. When he has a quick coffee break, he checks *Stocks on the Move* at Investors.com for stocks that are moving up or down on heavier than average volume signaling institutional buying or selling. (Seen in IBD's unique Volume % Change.) This often alerts him to stocks that he puts on his watch list. Bharani bought Tractor Supply out of a 3-weeks-tight pattern in March 2012 for a 20% return.

• KEY POINT •

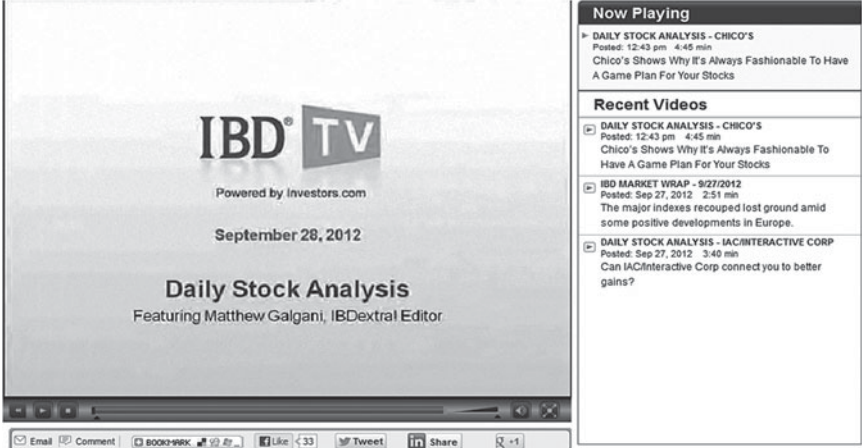
- Check *Stocks on the Move* at Investors.com for stocks moving up on above average volume.

IBD's Videos and Weekly Radio Show

Brian Gonzales

Brian works in the IBD Meetup Development Department. When he was first learning the CAN SLIM Investing System, he says, "The most helpful tool I found was to watch the *Market Wrap* video on Investors.com/IBDTV because it helped me stay in touch with what the market was doing on a daily basis as well as how leading stocks were performing."

He also watched the *Daily Stock Analysis* video to help learn how to analyze a stock's chart pattern and which fundamental elements he should be paying attention to the most.



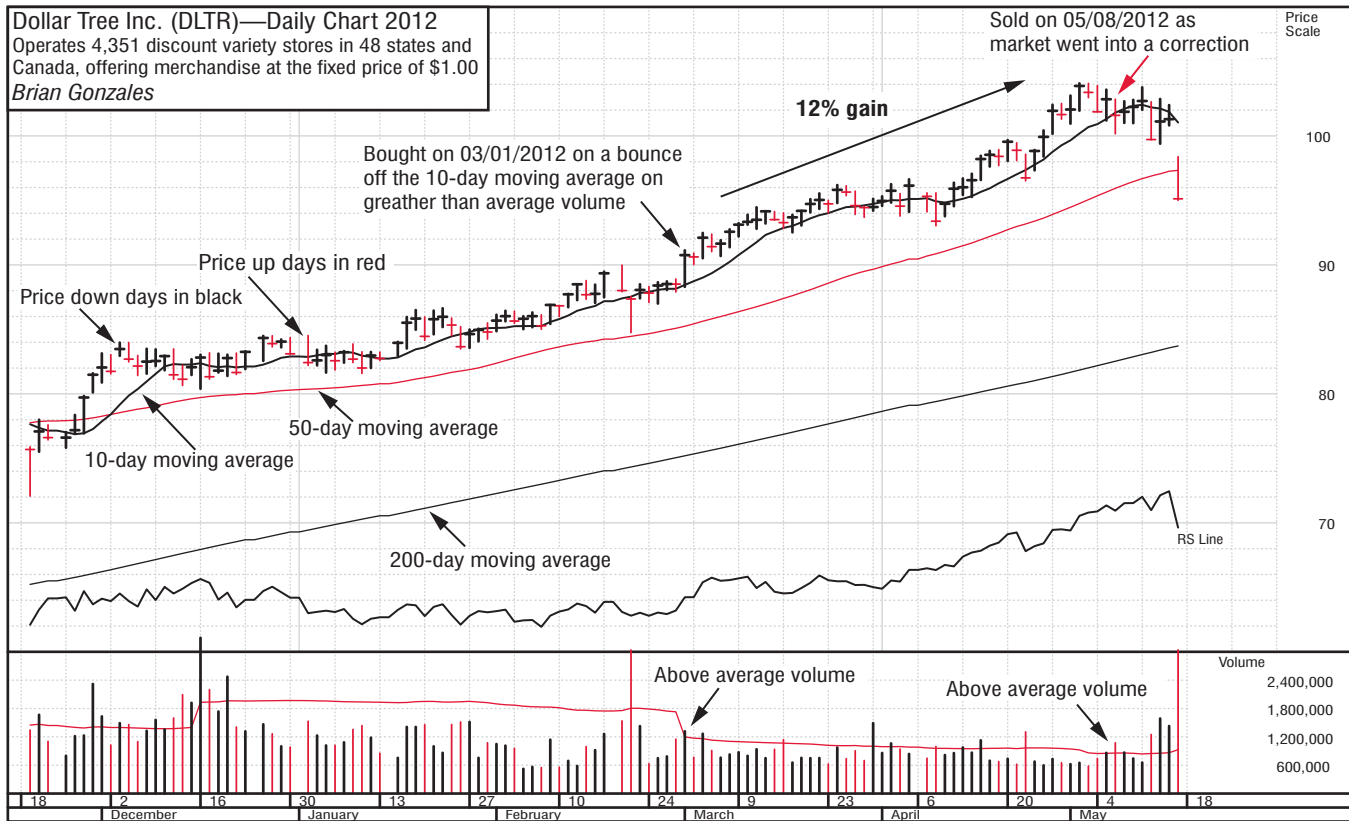
The screenshot shows the IBD TV website interface. The main video player displays the IBD TV logo and the title 'Daily Stock Analysis' featuring Matthew Galgani, IBDextral Editor, dated September 28, 2012. Below the video player are social media sharing options (Email, Comment, RSS, Facebook, Twitter, LinkedIn, etc.). To the right, the 'Now Playing' section shows a video titled 'DAILY STOCK ANALYSIS - CHICO'S' posted at 12:43 pm, 4:45 min. Below that, the 'Recent Videos' section lists several other videos, including 'DAILY STOCK ANALYSIS - IAC/INTERACTIVE CORP' and 'IBD MARKET WRAP - 9/27/2012'.

Browse	Recently Viewed	Comments		Date/Time
Daily Stock Analysis	Title	Description		
Education	Daily Stock Analysis - Chico's (4:45)	Chico's Shows Why It's Always Fashionable To Have A Game Plan For Your Stocks		12:43 PM
Forex	Daily Stock Analysis - IAC/Interactive Corp (3:40)	Can IAC/Interactive Corp connect you to better gains?		Sep 27, 2012
IBD 2-Minute Tips	Daily Stock Analysis - Sourcefire (2:58)	Will Sourcefire ignite traders' profits?		Sep 21, 2012
IBD Webinars	Daily Stock Analysis - QNC Holdings (3:06)	Can QNC Holdings bulk up your returns?		Sep 20, 2012
	Daily Stock Analysis - Panera Bread (3:45)	Will Panera Bread bake up big gains for investors?		Sep 14, 2012
	Daily Stock Analysis - Strategy (3:45)	Can you design a winning portfolio with Strategy?		Sep 13, 2012
	Daily Stock Analysis - LinkedIn (6:08)	Should investors stay connected to LinkedIn even after its breakout?		Sep 7, 2012
	Daily Stock Analysis - NetSolve (4:35)	Can NetSolve soar into the clouds?		Sep 6, 2012

From watching the videos, Brian learned more about Dollar Tree's chart action. He was familiar with the store because his sister shopped there frequently for school supplies, decorations, and party favors for her children's birthday parties.

Brian decided to go into one of the stores to investigate. He thought Dollar Tree reminded him a lot of Target stores, only on a smaller scale, and he observed that the stores were inviting and had several products that seemed to appeal to a large number of people both young and old. There were floral supplies, cleaning products, kitchen and hardware goods, health and personal care items, as well as food items, all at very reasonable prices.

After studying the chart and fundamentals further, he bought the stock March 1, 2011, as it bounced off the 10-day moving average and held the stock till May 8, when the market went into a correction, for a gain of 12%.



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• KEY POINTS •

- Watch the *Market Wrap* and *Daily Stock Analysis* videos to find winning stocks and to improve chart reading skills.
- Market corrections sometimes cause stock gains to be smaller if the trade was made shortly before the correction.

Jason D'Amore

Jason works in the Meetup Development Department after first working in customer service. He says that listening to the weekly IBD radio show helped cement a lot of the CAN SLIM principles, particularly when he was first learning the system.

Besides working with IBD Meetup Groups, Jason helped on the weekends at several of IBD's educational workshops. "This gave me the opportunity to listen to some of IBD's best speakers, such as Justin Nielsen and Scott O'Neil," he says. "Both of these speakers have worked very closely with William O'Neil, so listening to their insights on his investing successes was extremely exciting and helped me understand CAN SLIM on a deeper level.

"Lululemon was my first successful stock trade," Jason says. "It had formed a three-weeks-tight pattern (which is when a stock closes three weeks in a row with less than a 1% closing price change on each of those weeks). I first became aware of Lululemon from listening to the IBD radio show and bought the stock as it came out of an area of consolidation. I had conviction in the stock because I had visited one of their stores and was impressed with the quality of the merchandise."

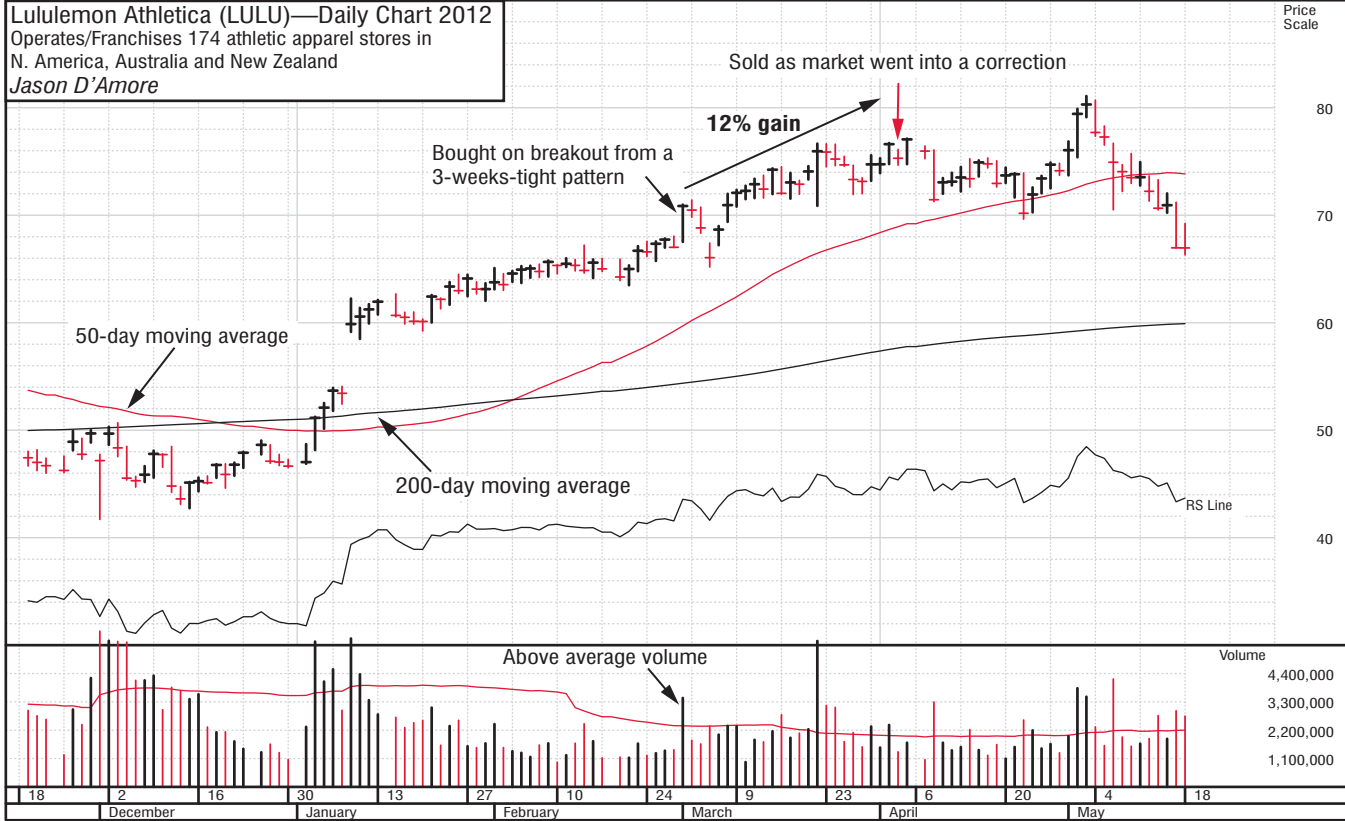
• KEY POINTS •

- Attend IBD's educational workshops.
- Listen to IBD's *How to Make Money in Stocks* weekly radio show at Investors.com/radioshow.

Lululemon Athletica (LULU)—Daily Chart 2012

Operates/Franchises 174 athletic apparel stores in
N. America, Australia and New Zealand

Jason D'Amore



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Kevin Dai

Kevin became an IBD subscriber in 2004 but said his learning curve took a big jump when he joined the San Jose IBD Meetup Group. “I started to really learn how to use the paper more effectively to find great stocks,” he says. “I also began to understand the importance of follow-through days and paid attention to stocks that broke out of base patterns soon afterward since they often go on to become the big leaders in a rally.”

He reads several features in the paper to find stocks but particularly likes the *Industry Themes* article to help him find winning stocks from the top performing industry groups. Kevin has been to IBD’s advanced workshops several times and shares his thoughts on what he has learned.

Kevin’s five-year cumulative return is 580%.

• KEY POINTS •

- Keep your ego out of trading. Psychology is very important; you must remain unbiased and flexible.
- Respect what the market is doing.
- Establish a regular routine; this will keep you from getting sloppy.

Google Heads Top Stocks In Online Content

IBD INDUSTRY THEMES

BY ALAN R. ELLIOTT
INVESTOR'S BUSINESS DAILY

All in all, it wasn't a great week for industry groups. Just over a third of the 197 groups tracked by IBD gained ground in the five days through Friday. More than half of those rose less than 1%.

The Internet content providers group managed a gain of better than 3%. It edged up to a No. 30 ranking Friday, from No. 54 at the start of August. The industry is home to familiar online names, including **Google**^{GOOG}, **Facebook**^{FB} and **Yahoo**^{YHOO}.

A number of stocks in the group are sketching interesting chart patterns and hold improving fundamentals. Google jumped 3% for the week, ending just 2% below its all-time high, set in 2007. Its vitals earn it a best-possible Composite Rating of 99. Anyone who reads IBD's mini-chart analysis knows the stock is 7% past a three-weeks-

5

• CHAPTER •

Kicking the Bag: Learning to Take Losses and Sell Rules

“Pain is the best instructor, but no one wants to go to his class.”

—TAEKWONDO MASTER HONG HI CHOI

The repetition of kicking the bag in martial arts equals the true birth of skill. The most important thing every investor must learn is to keep all losses small and move on to the next trade. As legendary trader Jesse Livermore put it, “Take your losses and don’t brood about them.”

No one is right 100% of the time in the stock market. Famous Wall Street investor and political consultant to U.S. presidents Bernard Baruch said it best: “If a speculator is correct half of the time, he is hitting a good average. Even being right three or four times out of 10 can yield a person a fortune if they have the good sense to cut their losses quickly on the ventures where they have been wrong.”

The secret to winning big in the stock market is not to be right all the time but to lose the smallest amount of money when you’re wrong.

In *How to Make Money in Stocks*, Bill O’Neil says, “You have to realize when you may be wrong and sell a stock without hesitation. How do you know if you’re wrong? The price of the stock will drop below what you paid for it!”

The cardinal rule in CAN SLIM Investing is to cut all losses at no more than 7 to 8% below the price you paid for a stock. Preservation of capital is the most critical part of investing.

That means if you paid \$30 for a stock, you would sell if the stock dropped to \$27.60, 8% below your purchase price. But you don’t have to wait till a stock is down 8% from where you bought it. A trade that is going against you can be sold with a smaller loss, say, 4 to 5% below what you paid for it. The point is to keep your losses as small as possible.

Steep losses require big gains just to break even.

- A 25% loss requires 33% gain to break even.
- A 33% loss requires 50% gain to break even.
- A 50% loss requires 100% gain to break even.

“He who hesitates, meditates in a horizontal position.”

—SENSEI ED PARKER

Selling a losing position must become automatic. You cannot hesitate. Consider trade triggers through your brokerage account if you have trouble with selling. That way, you’ve put in a predetermined sell price. This will help keep your emotions under control and keep you from freezing at a critical moment.

Simple Sell Rules

Take most profits at 20 to 25% unless a stock runs up 20% in 2 to 3 weeks, and then it must be held after its breakout for eight weeks. IBD studies show that some of the market’s biggest leaders will have a sharp advance before heading even higher, so holding onto these potential big winners is important.

The reason most stocks are sold at 20 to 25% gains is because many stocks will slow down, consolidate their gains, and build another base at that point.

A stock may be topping if it has:

1. **Greatest weekly price spread.** On a weekly chart of a stock with a big weekly gain, consider selling if the spread from the absolute low to the absolute high of the week is wider than any price spread in any week so far.
2. **High volume break of the 50-day moving average.** Consider selling a stock if it clearly drops below the 50-day moving average line and closes the week on heavy volume. It may mean institutions have stopped supporting the stock.
3. **Largest daily price run-up.** If a stock closes for the day with a larger price increase than on any previous up day since the beginning of the whole move up, watch out! This usually occurs very close to a stock's peak.
4. **Heaviest daily volume.** The ultimate top might occur on the heaviest volume day since the beginning of the advance, especially on a high volume reversal day.
5. **Signs of distribution.** Repeated high-volume selling days or heavy daily volume without further upside price progress signals institutional selling.
6. **Increase in consecutive down days.** For most stocks, the number of consecutive *down* days in price over a few weeks relative to *up* days in price will probably increase when the stock begins to come down from its top. You may see four or five days *down*, followed by 2 or 3 days *up*, whereas before you would have seen 4 days *up* and then 2 or 3 *down*.

Low volume and other weak action:

1. **New highs on low volume.** Some stocks will make new highs on lower or poor volume. As the stock goes higher, volume decreases, suggesting that big investors have lost their appetite for the stock.
2. **Greatest one-day price drop.** If a stock has already made an extended advance and suddenly makes its greatest 1-day price drop since the beginning of the move, consider selling if the move is confirmed by other signals.
3. **Living below the 10-week moving average.** Consider selling if a stock has a long advance, then closes below its 10-week moving average

and lives below that average for 8 or 9 consecutive weeks, unable to rally and close the week above the line.

Don't get shaken out too early. About 40% of stocks you buy will pull back near your initial buy point (also called the *pivot point*) sometimes on big volume for 1 or 2 days. Don't get scared out on this normal yet sharp pullback in price. As long as your loss-cutting price has not been reached (8% below what you paid for it), sit tight and be patient. Sometimes it takes a number of weeks for a stock to slowly take off from its launching pad. Big money can only be made by waiting.



Sparring with the Opponent: Arguments with the Ego

*“The way of the sword and the way of the Zen are identical,
for they have the same purpose, that of killing the ego.”*

—YAMADA JIROKICHI

Learning to keep emotions under control is one of the most crucial elements to becoming a successful investor but one of the hardest things to achieve. When your money is on the line, it is very common to wrestle with a multitude of emotions and make investing mistakes as a result. Emotions that every investor must learn to deal with are hope, fear, and greed.

Hope

Jeannie McGrew has a natural bullish bias when it comes to the market. Part of this is because her general outlook is always positive. She’s a very happy person, which is a wonderful trait to have in life but one that can get you into trouble in the stock market. Jeannie sometimes stayed invested when she

shouldn't have because she was "so sure the market was going to continue to go higher." Because of this overly optimistic attitude, Jeannie gave back some very nice gains made in an uptrending market by not going to cash when the market began to correct. Since the vast majority of stocks move up or down with the general market, it's critical to pay attention to this.

Jeannie realized that a lack of discipline was the problem and decided that a remedy would be to "pay a huge amount of attention to the overall market direction, because this will determine your level of success." Now Jeannie makes sure to monitor the overall trend before making any investing decisions.

Fear

Fear of losing money is quite common in stock investing, particularly if someone is new to investing. When Brian Gonzales was relatively new to investing, he would nervously watch stocks that he owned throughout the trading day, because he was afraid they would go down and he'd lose money. When his IBD Meetup Development colleague Jason D'Amore was beginning to invest, he too admitted to "being very tentative about losing gains that I made. I sold a couple of positions very quickly after the stock went down a few percentage points, which ended up being too soon, because I was afraid of losing money."

To alleviate their fears and remove any possible emotional trading, they both set predetermined sell triggers through their brokerage accounts, which would be 4 to 5% below their original buy points on any stocks that they owned. By placing the trade triggers, their losses would be small if a stock purchase that they made didn't work out. It also meant they didn't have to watch their stocks anxiously during market hours. The key thing that both of them have learned is the importance of having a set of rules and staying true to them. Brian says, "Rules keep me grounded and help remove the fear and uncertainty." He has watched friends invest without any rules or system and has seen them lose large amounts of money in the market as a result. Brian says, "The 'throw a dart at a stock and hope it goes up' method of investing can be very dangerous."

Greed

Gennady Kupershteyn had been trading stocks since college in the early 1990s when, at the tender age of 18, he was given the nickname "Stock

God.” While his friends were drinking beer downstairs, he was upstairs in his dorm room looking at stock charts. By 2005, his portfolio had grown to \$2 million, but he says greed was beginning to set in, and Gennady started taking too many losses as a result. He admits he would sometimes make a significant amount of money and then give all of it back, because he wasn’t keeping his sell rules.

Gennady’s desire to make money also caused him to ignore the trend of the overall market. Because of the volatility that Gennady experienced with his portfolio, he adjusted his stop losses, the price at which he would sell a stock if it dropped below his purchase price. In a more choppy market, Gennady learned to keep a tighter leash on his positions and sell sooner. “Emotions can get the best of you,” he said, “and bad decisions often lead to more bad decisions if you don’t have your rules in place.”

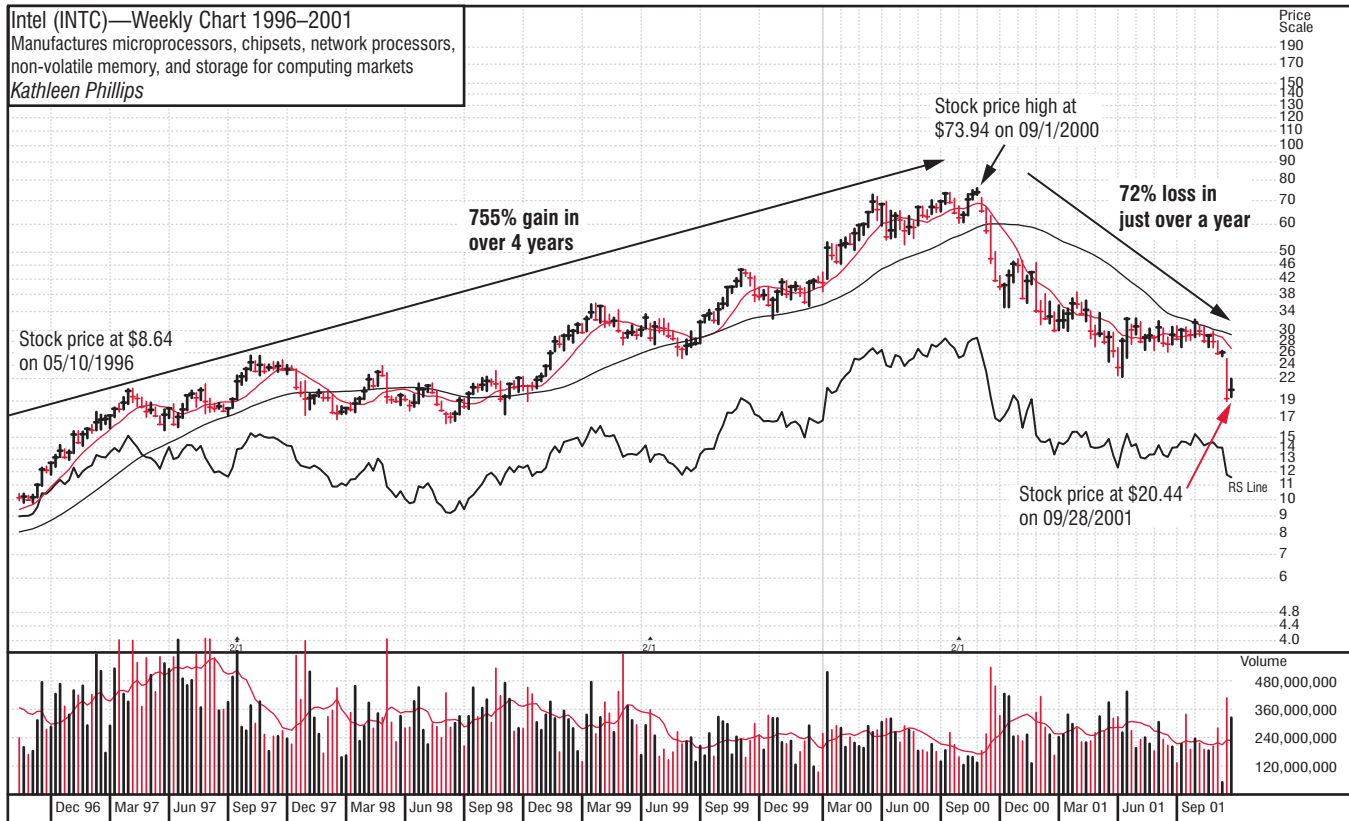
Never Fall in Love with a Stock

Kathleen Phillips had a sizable portfolio back in the 1990s and ran it up to a jaw-dropping amount. At that time, she held strong companies like Cisco Systems, Intel, Microsoft, and other tech titans. This was a dream portfolio that she thought would run up even higher. There was one problem. She had fallen in love with her stocks, because they had given her such large gains. Kathy didn’t realize how bad a bear market could be and how much her stocks could correct when the entire market was under tremendous selling pressure. As a result, Kathy gave back a large portion of her gains.

Today, Kathy has a much greater understanding of market cycles and has a set of rules to make sure that she locks in gains and vows to “never fall in love with a stock again.”

Bad Habits

Lee Tanner said his bad habits started in the 1990s, when investing was much easier and the market was more forgiving if you made a mistake. He picked some great stocks using the CAN SLIM strategy and made some very nice gains but was “quite sloppy and lazy on the sell rules.” One stock that Lee had tremendous success with as a newer investor was JDS Uniphase. He bought the stock in 1997 and watched it soar through early November 1999. By that point, Lee was up 1,450% on his original investment. Lee was elated and quite generous that Christmas with gifts to friends and family.



By late January 2000, Lee's position in JDS Uniphase was up more than 3,700% from a split adjusted initial position of \$3.25 to over \$125. This was a time of tremendous excitement. What Lee didn't realize, though, was that the stock had just gone through an enormous climax run—after which most stocks correct sharply.

Lee was surprised by the sharp pullback in JDS Uniphase and held the stock until it plunged all the way back down to around \$20 in May 2001. He was so sure it would recover. Lee says his bad habits and “sloppy sell rules” had caught up with him. “Looking back,” he says, “it is simply flabbergasting that I held this stock all the way down from \$150 to \$20.”

Lee regrouped, attended several IBD Seminars, and went back to the basics. He knew that he needed to approach investing in a more disciplined way. Lee has learned that investing “is kind of like baking an apple pie. You have a recipe, and you need to follow it. You must follow the rules to take the emotions out of it.” Lee says he learned this the hard way, but it's made him a better investor in the long run.

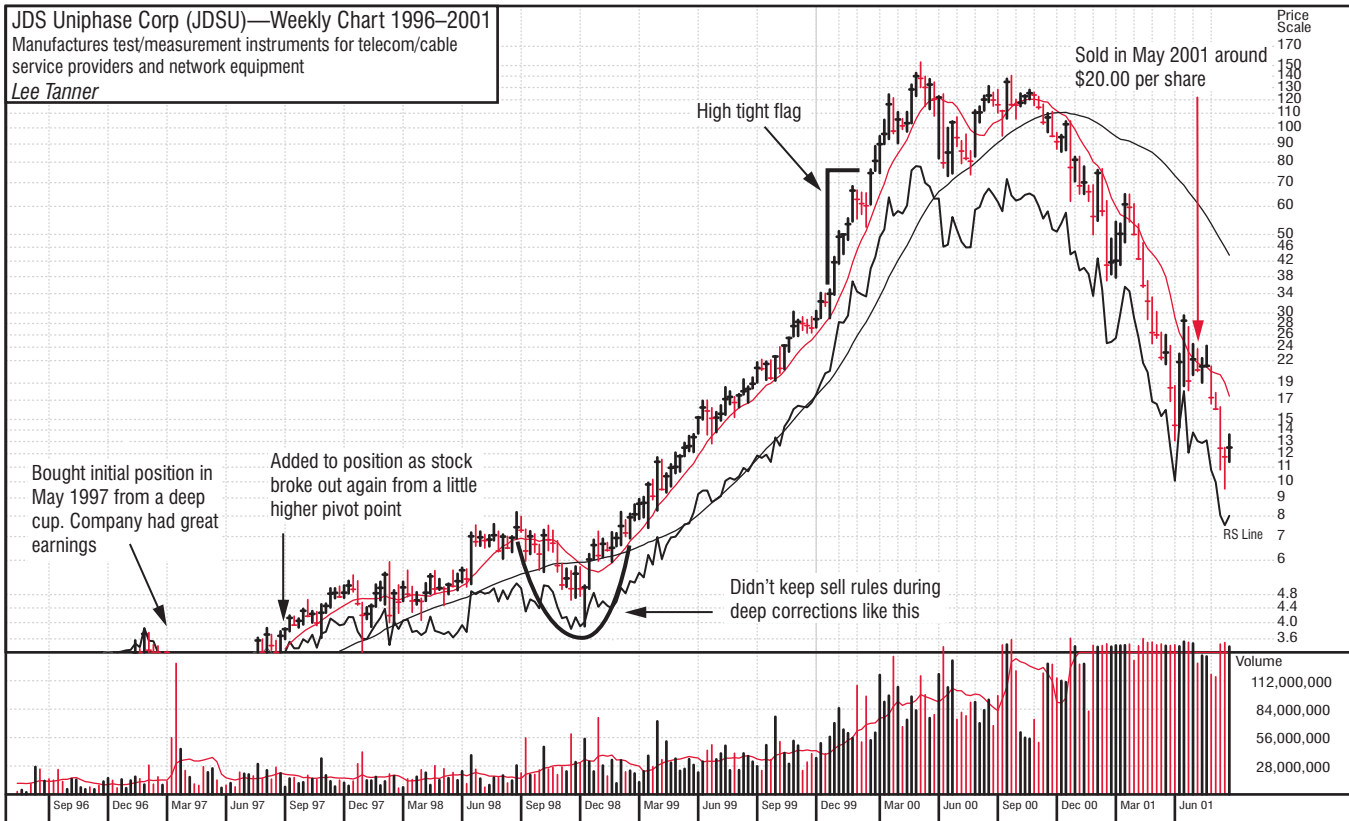
Arguments with the Ego

“Aloha Mike,” as he is known in investing circles, followed every CAN SLIM Investing rule when he was a newer investor. This led to several years of substantial gains in the market, but the more successful he was, the more his ego became a problem, and he began breaking the sell rules. “Instead of taking a 7 to 8% loss in a stock, the supposedly smarter me was selling at 25 to 40% losses, because I was so sure I knew what I was doing.”

Reviewing how much money he lost by not keeping the 7 to 8% sell rule “was a real shocker.”

“Aloha Mike” faced the fact that every trade he made could be a possible mistake and that those mistakes must be corrected quickly, and all losses must be kept small.

A firm set of rules helped “Aloha Mike” have a concrete way to deal with the market that has nothing to do with his emotions. He has a plan for three roads that the market can take. “Stocks can go up, they can go down, or they can stay in a sideways trading range,” he says. “Keeping the three roads in mind allows me to stay nimble and not get mentally stuck in one scenario when another fork in the road or the market may occur.”



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His overall goal is to be in sync with the market and leave his emotions and ego out of the equation completely. The market “is like a ballroom dance: it leads, and we must follow. I try and look at what the market is telling me and ignore all the other voices including my own.”

Mike Scott admits to having an ego also. Sometimes intraday volatility makes him want to buy or sell something. There are four things that he does to keep his ego and his emotions under control:

1. Stop looking at 5-minute intraday charts and watching a stock's move every minute during the trading day.
2. Wait until the end of the day to decide whether to buy or hold a stock, allowing decisions to be calm, rational, and less emotional.
3. Use a weekly chart as the primary way to analyze and make decisions. The weekly chart shows a longer period of time to analyze a stock's trend and lessens emotions associated with daily fluctuations.
4. Get up and walk away from the computer when these strategies don't work.

Mike takes walks or rides a bike during the trading session when he discovers that he wants to take action and is about to break some of his trading rules.

Years ago, Mike learned Zen meditation at the Zen Center in Los Angeles. Meditation is also something that he does to help him stay focused and relaxed.

Successful trading begins in the mind. The best traders find a way to relax and get focused, whether it's listening to music, taking a walk, exercising, or meditating. Taking time away from the market is important. A trader must get back to a grounded place in order to think clearly and operate from a nonemotional place.

• KEY POINTS •

- Check the market trend before making any trades.
- Consider setting sell triggers to keep losses small.
- Keep greed under control by selling most stocks at a 20 to 25% gain.
- In a choppy market, sell positions sooner.
- Never fall in love with a stock.
- Fix bad habits, and follow a set of rules to keep emotions under control.
- Find a way to relax and get focused.

Breaking Boards: Successful Trades and Lessons Learned

*“The successful warrior is an average human being
with laser-like force.”*

—BRUCE LEE

For a martial artist, breaking through wood boards and even cement blocks is less about brute strength and more about specific techniques. You must not break your form; if you do, fingers and wrists can be broken!

Investors can run into the same dangers if they try and create their own system or rules. The good news is that many traders have found success as a result of staying true to the CAN SLIM Investing System. The best part is that if you’ve had a successful trade once or twice, you can do it again using the same principles.

Keep It Simple

“Aloha Mike” is retired from the aerospace industry. He was able to achieve this by the age of 55 because of his success with the CAN SLIM strategy,

which he began in 1987. He's very encouraging to newer investors and mentors a group of retirees as a way of giving back to the community. "The average person can definitely learn to invest successfully if they are willing to put in some time and effort," he says.

"Aloha Mike" says there are three key elements to investing:

1. **Market Timing.** Get in sync and stay in sync with the market direction.
2. **Stock Selection.** Find the great CAN SLIM stocks that are moving up.
3. **Money Management.** Start your positions small. Add if you're making gains.

"What you want to do is force-feed stocks that are outpacing the market," says Mike. "Never average down and add to stocks that are going against you."

One of Mike's best trades was with NVR Inc., the parent company of Ryan Homes, NVR Homes, and Fox Ridge Homes. Mike traded in and out of the home builder, capturing 300% of its 429% move.

"Aloha Mike" rewards himself with a new Hawaiian shirt every time he makes a 25% gain in a stock and says he has a closet full of them.

• KEY POINTS •

- Follow the market direction.
- Select the best CAN SLIM stocks that you can find.
- Start your positions small; add if you're making gains.

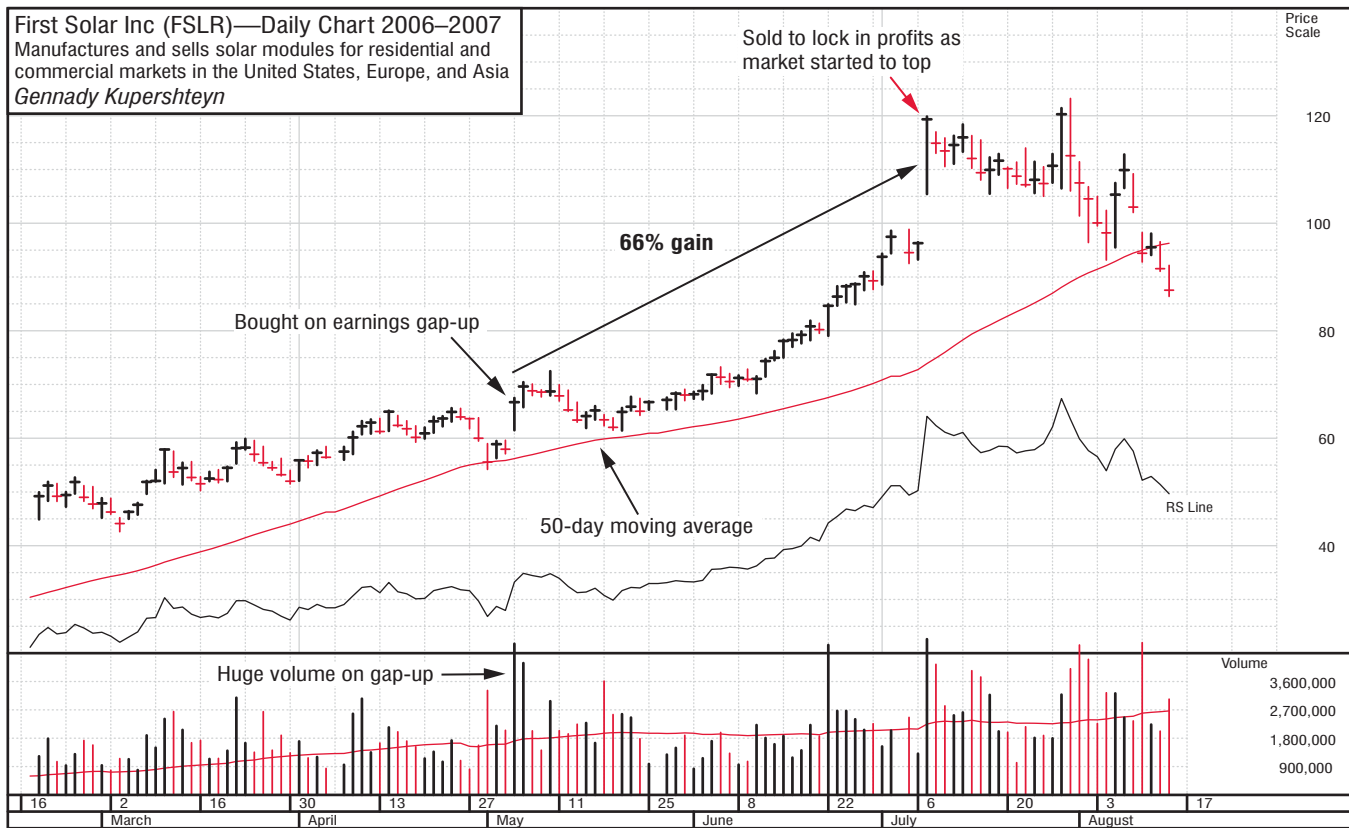
Wait for a Follow-Through Day: The Market Is Not a Casino

Gennady Kupershteyn's years of investing experience have taught him that there are optimum periods of time for owning stocks.

"After the market issues a follow-through day," says Gennady, "volatility usually quiets down, and it becomes much easier to hold stocks, particularly if you're following the rules. The key is to be patient and extremely selective. Within four weeks of a successful follow-through day, new high quality names will begin to break out.

"A lot of people have said to me that investing in the stock market is like gambling, but to me, the market is only like a casino if you treat it like one,"

First Solar Inc (FSLR)—Daily Chart 2006–2007
 Manufactures and sells solar modules for residential and commercial markets in the United States, Europe, and Asia
Gennady Kupershteyn



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says Gennady. “With investing, you’re trying to put the odds in your favor. Unlike gambling in a casino, you can walk away from a trade with a small loss if it begins to go against you, because you’re following a set of sell rules. But once you place your bet in the casino, try telling the dealer that you’d like a brand new hand because you don’t like the way he dealt the cards.”

Over the years, Gennady has taught and attended many IBD Meetup Groups. He found one great stock in 2007 by attending a New Jersey IBD Meetup. “For some reason, the energy stocks had escaped my radar,” says Gennady. “When I heard the Meetup group discuss the triple digit earnings in First Solar, I did more research and ended up profiting nicely from the stock.”

By being in the market at the right time and obeying his rules, Gennady has notched some nice gains over the years.

Dell. 1995–1997: 529% gain

First Solar. 2007: 66% gain

Fuji International. 2009: 52% gain

Abercrombie and Fitch. 2010: 38%

• KEY POINTS •

- Wait for a follow-through day.
- Don’t gamble in the stock market; keep a set of rules.
- Attend an IBD Meetup Group, and learn about stocks you may not be familiar with.

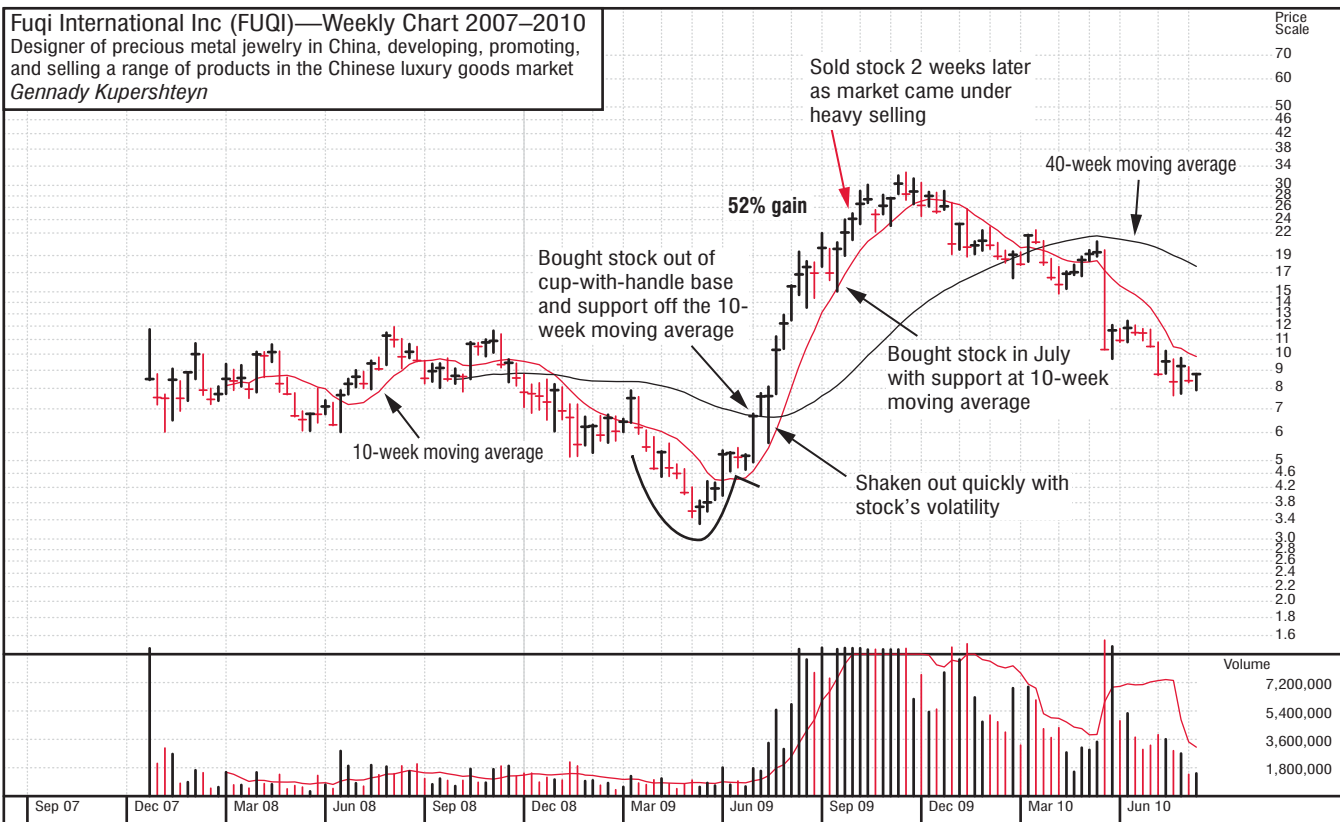
Finding Stocks with a Simple Daily and Weekly Routine and a Winning Attitude

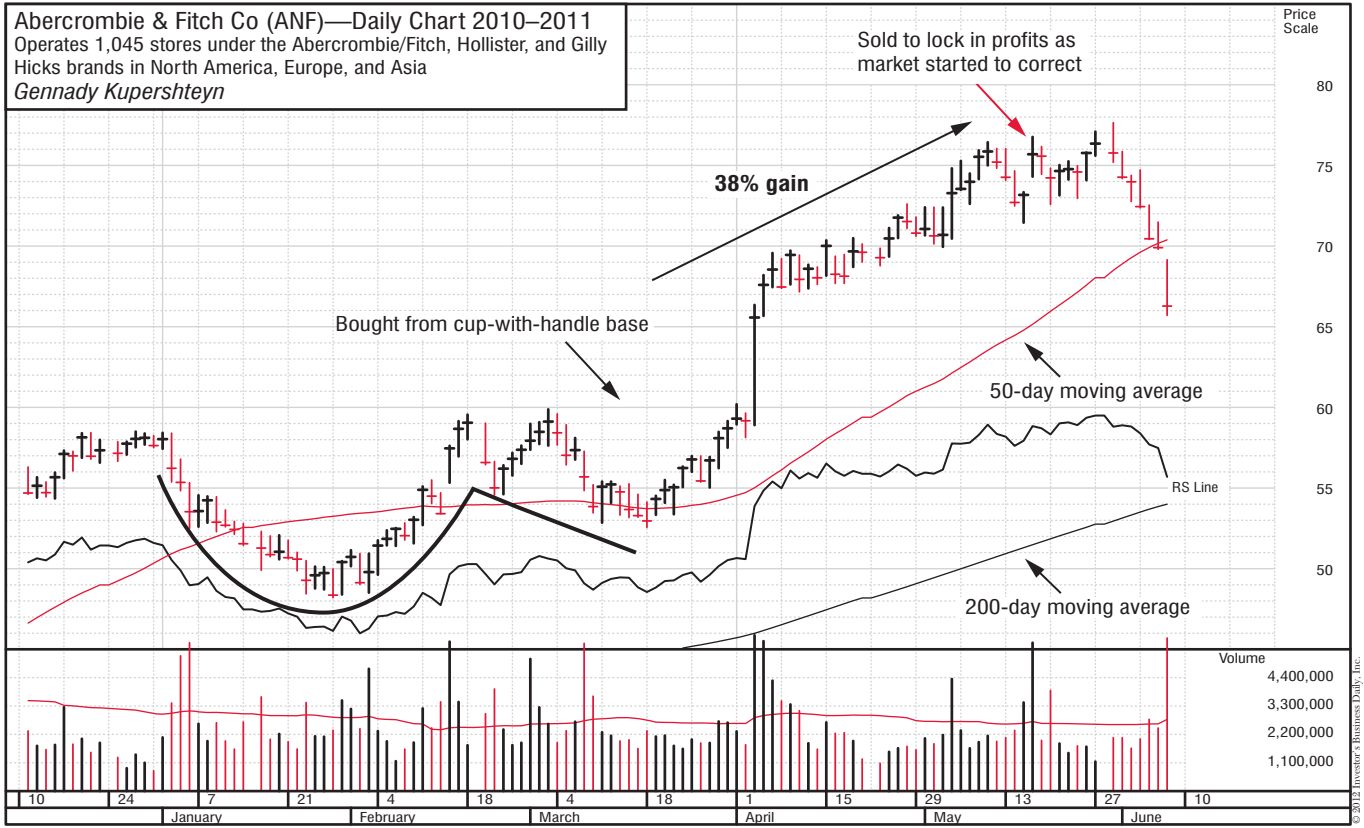
Ken Chin says, “I go through the print version of IBD with a cup of coffee in the evening, circling stocks in various features of the paper that may be approaching a potential buy point. I’m a dentist, so during the day I’m pretty busy, but in between treating patients, I go to Investors.com and quickly check *Stocks on the Move* to see which stocks are moving up in heavy volume, signaling that institutions might be buying shares of a stock that I’m interested in.

Fuqi International Inc (FUQI)—Weekly Chart 2007–2010

Designer of precious metal jewelry in China, developing, promoting, and selling a range of products in the Chinese luxury goods market

Gennady Kupershteyn





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“On the weekends,” continues Ken, “I read through the Friday edition of the paper, paying special attention to *Your Weekly Review*, and the Monday version of the paper, which has the *IBD 50*. Both of these sections have mini charts with a description underneath them of the stock’s base pattern and the potential buy point. This provides me with a quick and easy watch list of stocks.

“I also study *The New America* articles. As creatures of habit, we return to stocks that have made us money in the past and shun those that haven’t. *The New America* articles have opened my mind to companies that I never would have considered because I didn’t know enough about them.”

Ken says, “A mind once expanded will never contract to its original dimension.’ I can’t take credit for those inspiring words—they belong to Oliver Wendell Holmes—but IBD often prints these inspiring quotes in its *Wisdom to Live By* column. These quotes help me maintain a winning attitude, which is just as important as finding a winning stock. Without a winning attitude, you’ll limit yourself on how far you can go.”

That winning attitude has helped Ken achieve some stellar gains:

Baidu. 2010: 212% in 18 months

Apple. 2011: 91% in 18 months

• KEY POINTS •

- Check *Stocks on the Move* at Investors.com for stocks moving up on heavy volume, indicating institutional buying.
- Develop a nightly and a weekend routine for reading the paper.
- Study *The New America* articles to find potential big winners.

Follow the Market and Look for Setups and Breakouts

Randall Mauro is a portfolio manager for an investment firm in Colorado. He uses the CAN SLIM Investing strategy for his personal trading as well as for clients’ portfolios.

“When looking for positions to invest in,” he says, “I always start the process by gauging the strength of the overall market (the “M” in CAN SLIM),

THE NEW AMERICA

BAIDU INC., Beijing, China

Google's Fade In China Gives A Big Boost To Local Competitor

BY PETE BARLAS
INVESTOR'S BUSINESS DAILY

In the midst of a lackluster year for the stock market, Baidu continues to be the little engine that could.

Since Jan. 4, shares of China's top Web search service have more than doubled while stocks for most other technology companies are wallowing in the red over the same period.

BaiduTM has made a habit of beating analyst views on its quarterly profit and revenue results. The company's second-quarter report late last month was no exception.But Baidu can probably thank GoogleTM, the company's closest rival in the region, for at least some of the boost in share price this year.

Google's Fate

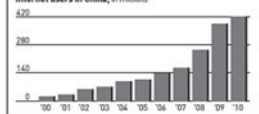
Analysts say Baidu's shares will likely continue to trade on Google's June decision to curtail its search-able Web index in China to comply with the government's censorship laws. The move reduced Google's presence in what has become one of the fastest-growing Internet markets in the world while opening the door for Baidu to get a bigger share, says Ryan Jacob, portfolio manager for the Jacob Internet Fund, which owns shares in both Baidu and Google.

"Baidu is in a unique situation where not only has their growth been strong but their accelerating because of the situation with Google," he said. "The fundamental change

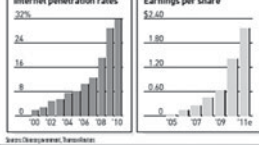
Going Online

Baidu, China's largest Internet search engine, is benefiting from the soaring number of Internet users.

Internet users in China, in millions



Internet penetration rates



has been the drop-off of Google as a significant competitor."

Searches on Google in China are now limited to categories that don't require the company to censor its results. The reduction in its index also limits Google's ability to monetize

the results with ads, a key benefit to Baidu and its shareholders, says Mayuresh Masurkar, an analyst for Kaufman Bros. Masurkar rates Baidu a buy.

"For both users of search and for advertisers who spend on (ads)

Baidu

Market cap	\$2.6B
Share price	\$34
12-month sales	\$1.4B
5-year profit growth rate	18%
2007 dividend	\$0.05
Composite Rating	99
Earnings Per Share	19
Relative Price Strength	10
Industry Group Rank	24
Sales/Profit Margin-ROE	A
Accumulation/Contribution	B
See www.baidustock.com for more info	

there is no other place to go but Baidu," he said.

The Baidu story also appeals to investors still searching for a growth opportunity in an otherwise overvalued market, says Alan Lance, president of Alan R. Lance & Associates, an investment adviser and money management company, which owns shares in both Baidu and Google.

"The Chinese market continues to grow, the economy is one of the strongest in the world and they lost their major competitor in Google," he said. "They probably could not have written a better script for 2008-2010."

And the story seems to keep getting better.

In the second quarter, Baidu held about 70% share of China's Web search market revenue, up from about 64% in the first quarter, says Analysts International, a research firm.

Meanwhile, Google's share of revenue

advertisers fell 0.9% from the fourth quarter.

Other metrics were equally compelling.

Revenue per customer in the second quarter also increased 18.9% vs. a year ago and 21.7% from the first quarter. In the first quarter, revenue per customer was up 34.1% vs. the year-ago period and up 1.6% from the fourth quarter.

In a July 21 conference call with analysts, Robert Li, Baidu's chief executive, said the company continues to capitalize on increasing numbers of advertisers jumping on its search service.

"We were able to monetize more effectively, and large companies and (small- and medium-sized) enterprises are spending more with us," he said. "The strength should continue as customers become more familiar with the platform's functions and see potentially higher ROI (return on investment)."

Li never mentioned Google. Neither did any of the other Baidu executives on the call.

But that's not surprising, says Kaufman Bros. Masurkar.

"They have traditionally been focused on their own initiatives and their own performance, so they don't talk much about the competitive environment," he said.

Baidu had another welcome surprise for investors in the second quarter.

Traffic Acquisition

let, says Lance.

"It just makes the story that much more exciting, and it's played out much better than most investors would have expected," he said.

China's online ad market is only a fraction of the market in the U.S., but it is growing fast. By 2010, sales of online ads in China will reach \$1 billion vs. \$1.5 billion in 2008, says eMarketer, a research firm.

The number of Internet users in China is now 120 million vs. 100 million in 2006. Yet almost 70% of the country remains offline, Li said during the call.

Baidu is working on several ways to drive more revenue, including online video and e-commerce services.

The company is also adapting its search service to mobile devices, which analysts expect should be a major growth area for the company.

Mobile Growth

However, Li cautioned that mobile is a work in progress because mobile phones are expensive in China, and the service is much slower than the PC-based Internet.

"During the past couple of years, we have seen a faster growth in mobile search traffic vs. PC-based search, but it remains a small percentage of our total traffic," he said.

Baidu could still face some local competition.

Alibaba Group, an e-commerce services company, recently purchased a 10% stake in Sogou, a search ser-

Going Online

Baidu, China's largest Internet search engine, is benefiting from the soaring number of Internet users

Internet users in China, in millions

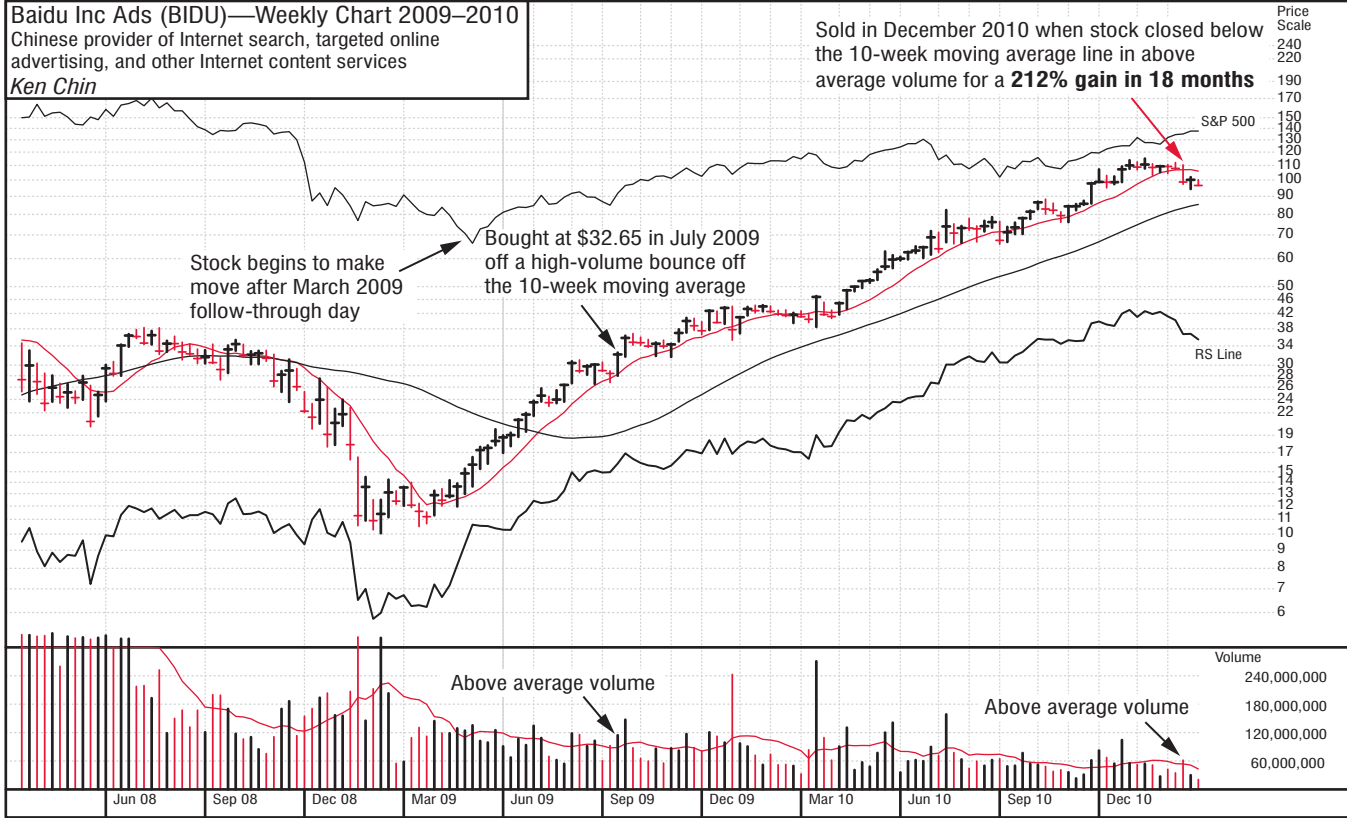
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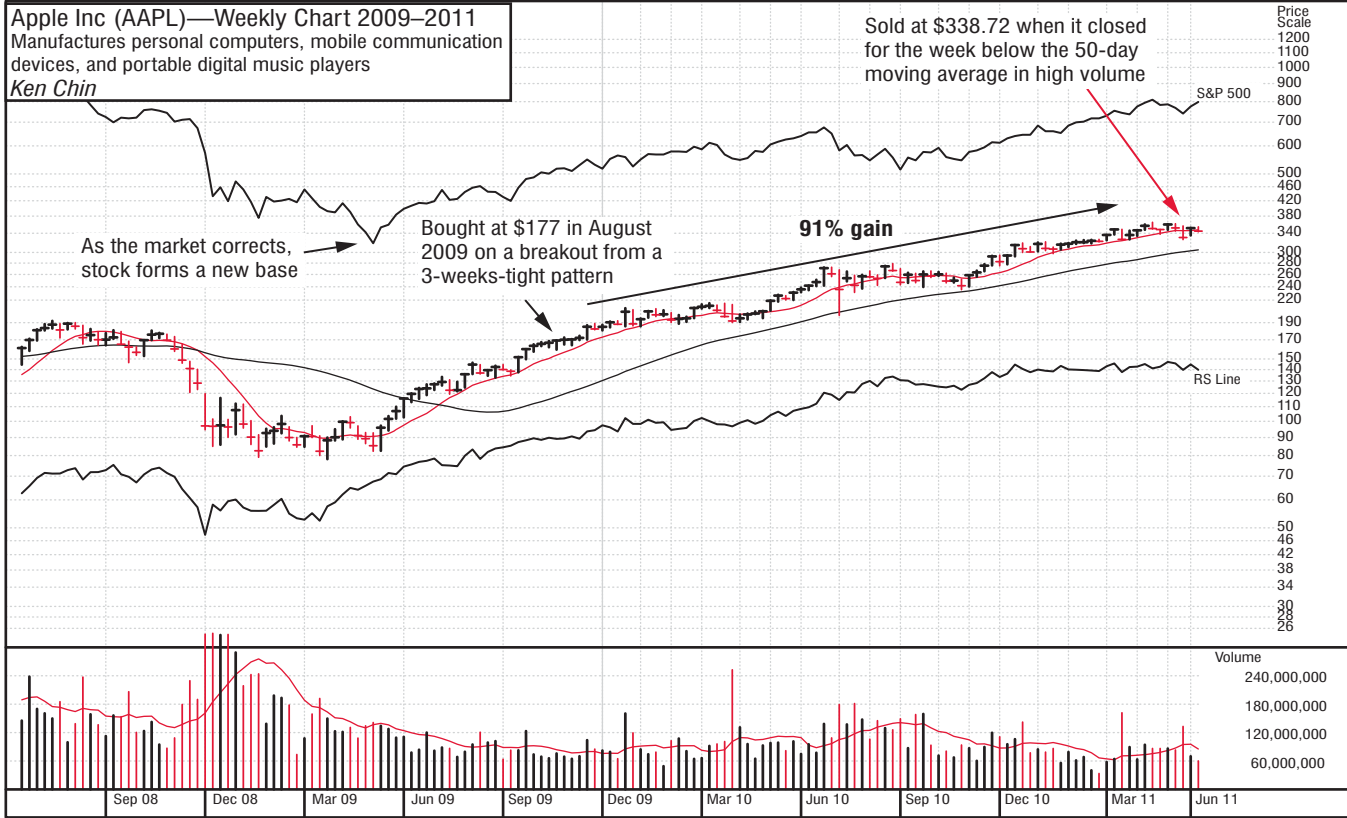
Year	Internet users (millions)
'00	0
'01	10
'02	20
'03	30
'04	40
'05	50
'06	60
'07	70
'08	80
'09	100
'10	420

Sources: Chinese government, Thomson Reuters



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Apple Inc (AAPL)—Weekly Chart 2009–2011
 Manufactures personal computers, mobile communication devices, and portable digital music players
Ken Chin



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because as IBD research has shown, most stocks follow the direction of the general market and, as a result, investing in an uptrending market is the safest, easiest way to make money.

“Looking at a Nasdaq chart,” he continues, “if you compare the price movements in early December 2011 with the previous few months, one could very easily see that things were getting quieter and less volatile. This told me that we were getting closer to a new uptrend and that the last quarter decline was nearing its end. On December 20, the market produced a follow-through day, and this indicated it was time to put our money to work.”

Randall says, “Whole Foods Market moved strongly in step with the market. This stock had been a strong mover over the past year, but I felt it was ready to move again after a short consolidation. Whole Foods sells organic and natural foods to an educated consumer and has the “N” in CAN SLIM: the organic movement is something I believe to still be somewhat new to the mainstream consumer world. I had been watching it since September, when it made a new price high while the market was still near the bottom of its correction. And as I’ve learned from reading *How to Make Money in Stocks*, when a stock is making higher highs counter to the general market, it shows strength and could very well be a leader in the next market uptrend.

“Although it was too early to enter Whole Foods on December 20, since the stock was still completing its base pattern, I noticed that the price-volume relationship was starting to become much more tight and controlled compared to the previous few months. Volume was starting to dry up on the down days and subtly increasing on the up days. This is the type of action I like to see before a stock breaks out.

“On January 9, Whole Foods was within 1% of its high on the left side of the cup. Then the stock declined in low volume down to the 10-day moving average, which showed that institutional investors were holding onto their positions and not selling as the stock pulled back gently in price. Then, on January 17, Whole Foods broke out of its cup-with-handle base on volume that was 149% above average, and I bought the stock.

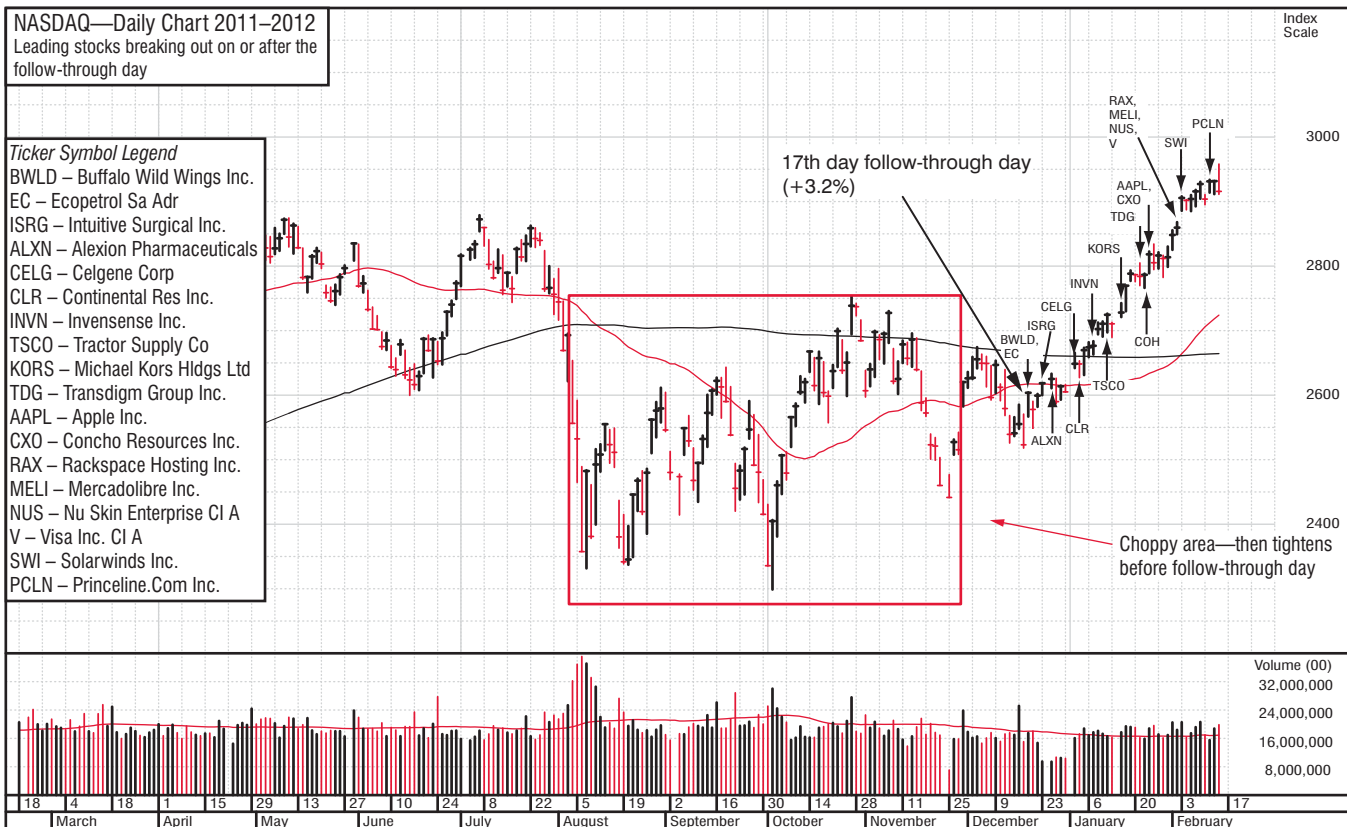
“The next week, the stock moved higher for a few days but then pulled back to the breakout price, which is common; 40% of stocks will pull back to the pivot. I wasn’t worried since I saw that the pullback was orderly and on low volume (buy point). The stock gained 30% over the next 5 months and largely ignored the correction that the general market experienced in April, May, and June 2012.

NASDAQ—Daily Chart 2011–2012

Leading stocks breaking out on or after the follow-through day

Ticker Symbol Legend

BWLD – Buffalo Wild Wings Inc.
 EC – Ecopetrol Sa Adr
 ISRG – Intuitive Surgical Inc.
 ALXN – Alexion Pharmaceuticals
 CELG – Celgene Corp
 CLR – Continental Res Inc.
 INVN – Invensense Inc.
 TSCO – Tractor Supply Co
 KORS – Michael Kors Hldgs Ltd
 TDG – Transdigm Group Inc.
 AAPL – Apple Inc.
 CXO – Concho Resources Inc.
 RAX – Rackspace Hosting Inc.
 MELI – Mercadolibre Inc.
 NUS – Nu Skin Enterprise CI A
 V – Visa Inc. CI A
 SWI – Solarwinds Inc.
 PCLN – Princlene.Com Inc.



“Everyone has a home run story to tell, but in the investing world, it’s the singles and doubles that add up to real results consistently over time. To steadily make money in the market, you must stay focused on preserving capital and minimizing risk. Investing when the market tells you it wants to go up—and staying in cash when the market starts to give signs of a top—are the most important criteria to remain profitable over the long run.”

• KEY POINTS •

- The most important part of investing is to determine the strength of the overall market. Read *The Big Picture* column daily.
- Investing in an uptrend is the easiest way to make money.
- Watch for stocks making new price highs counter to the general market; this shows strength.
- Search for stocks breaking out of base patterns or areas of consolidation after a new uptrend begins.
- Aim for singles and doubles for consistent results.

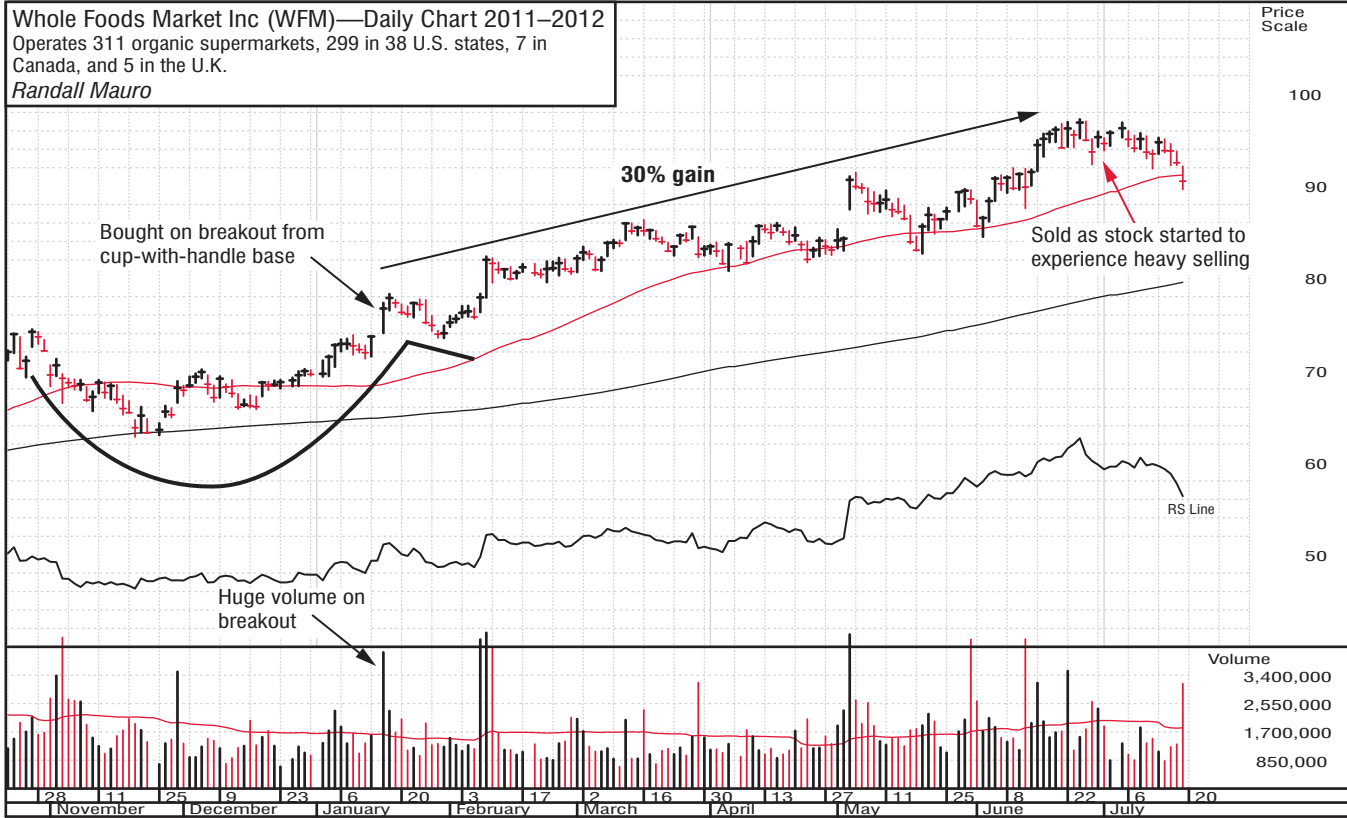
Using Leaderboard to Save Time

Kathleen Phillips likes Leaderboard, a streamlined list of IBD’s top performing stocks, “because it focuses on current market leaders that are ready to break out from their base patterns. The Leaderboard charts are annotated, showing the base pattern and the buy point. This saves me a lot of time by focusing on the very best stocks in the market with top fundamental ratings. I have done very well with stocks from the Leaderboard list, including Baidu, LinkedIn, Monster Beverage, Rackspace Hosting, and Tractor Supply. Leaderboard saves me a lot of time, and I have a lot of confidence in the product because I know the top editorial staff at IBD picks stocks for the list.”

Rackspace Hosting. 24% gain

Tractor Supply. 34% gain

Whole Foods Market Inc (WFM)—Daily Chart 2011–2012
 Operates 311 organic supermarkets, 299 in 38 U.S. states, 7 in Canada, and 5 in the U.K.
Randall Mauro



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• KEY POINTS •

- Use Leaderboard to save time and find IBD's best performing stocks.
- Learn more about base patterns from Leaderboard's annotated charts.

Look for Fashion Trends and Fads

“Surfer Pat” Reardon started his investing adventure by picking up an IBD newspaper as an assignment for an Economics 101 class at a local community college. Pat said he had no idea how this assignment would impact and change his life.

His original goal was to take real estate and construction classes and begin a career “buying some fixer uppers, remodeling, and selling them.”

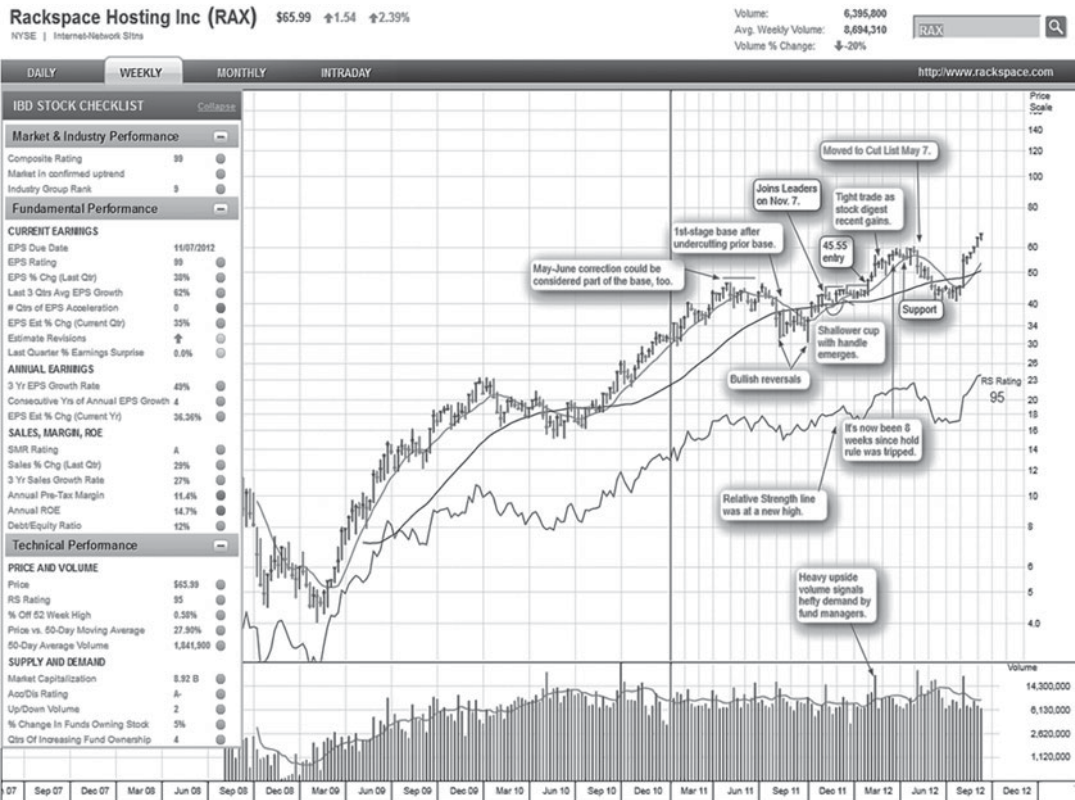
Pat's curiosity about the stock market led him to read several books: *How to Make Money in Stocks*, by Bill O'Neil; *How I Made \$2 Million in the Stock Market*, by Nicolas Darvas; and *Reminiscences of a Stock Operator*, by Edwin Lefevre. After reading these books, he completely changed his mind about wanting to go into construction. Pat decided he wanted to learn how to invest in stocks. And so he began investing.

“One of my early successes was with Skechers,” he says. “Their company headquarters was in my hometown of Manhattan Beach. I saw moms and kids wearing the fashionable athletic shoes, so I checked the IBD Research Tables and saw that Skechers had top ratings. Then I looked at their chart and waited until the stock broke out of an area of consolidation on big volume. At the time, I was trading a very small amount of money, but I made 20%, and that got my attention. From then on, I was very excited about the possibilities to make money in the stock market.

“Another stock I found by paying attention to fads was Hansen's Natural, the makers of the Monster Energy Drink. The stock had big earnings and sales and was written about in several IBD articles. I saw institutional money with heavy volume on a chart going into the stock, and bought it.”

Pat says his learning curve has been steady and gradual: “Going through several market cycles and gaining a better understanding of bull markets and the winners that appear in each new cycle helped me make some great profits in leading stocks.

Leaderboard Chart



“My best trades were done when I bought correctly and sold because I did my homework and followed the rules.”

Hansen’s Natural. 156% + 33% gains (two separate buys)

NetEase. 100% + 60% gains (two separate buys)

• KEY POINTS •

- Look for fashion trends. What’s new that everyone is wearing?
- Read books by legendary stock traders.
- Watch for food or drink fads.

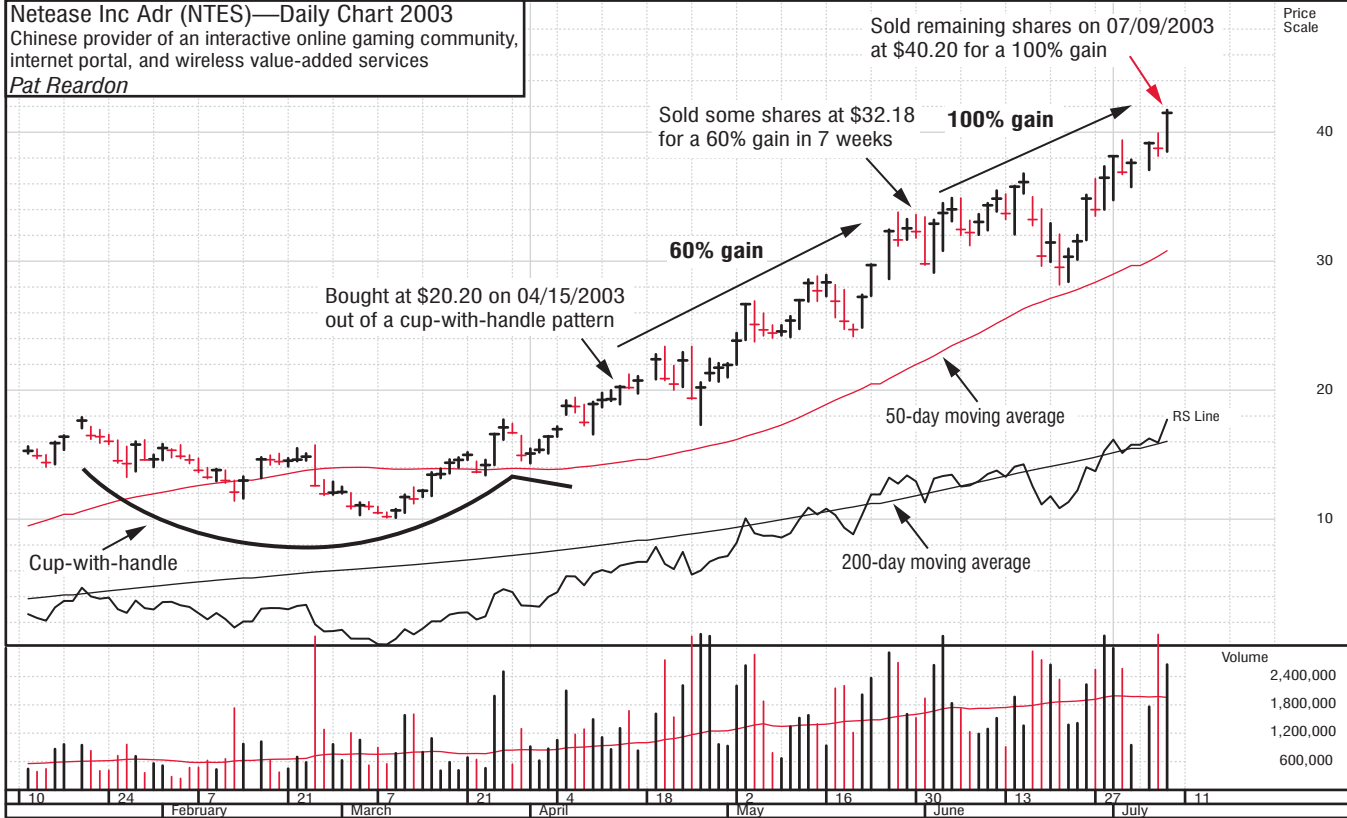
Tune Out the News

Dave Whitmer is a U.S. Navy F/A-18 Fighter Pilot and TOPGUN graduate. He has been actively trading using the CAN SLIM System since 2000.

In March 2009, Dave was on the Aircraft Carrier USS John C. Stennis in the Western Pacific Ocean. “This allowed me to distance myself from all the news,” he says. And much like legendary stock trader Nicolas Darvas, who was out of contact and away from the news while he traveled the world as a dancer in the 1950s, this would prove beneficial. Bill O’Neil also advocates tuning out the news and paying attention to what the market and leading stocks are actually doing.

Because of the ship’s security network, Dave could not access Daily Graphs (now MarketSmith, a premium charting research tool and sister company to IBD) for research, so he had to rely on a good friend, John Mackel, to help him fill in the blanks when it came to chart analysis. Because he had such limited time and access to news, Dave wasn’t influenced by media pundits who were saying the market would never turn around. Dave was interested in stocks that were showing strength and resilience despite the difficult market. He read about Green Mountain Coffee Roasters in *eIBD*TM (the digital version of IBD) and saw the stock setting up in a cup-with-handle base. Dave realized that as soon as the market turned around, Green Mountain Coffee Roasters would be a stock that he wanted to own.

Netease Inc ADR (NTES)—Daily Chart 2003
 Chinese provider of an interactive online gaming community, internet portal, and wireless value-added services
Pat Reardon



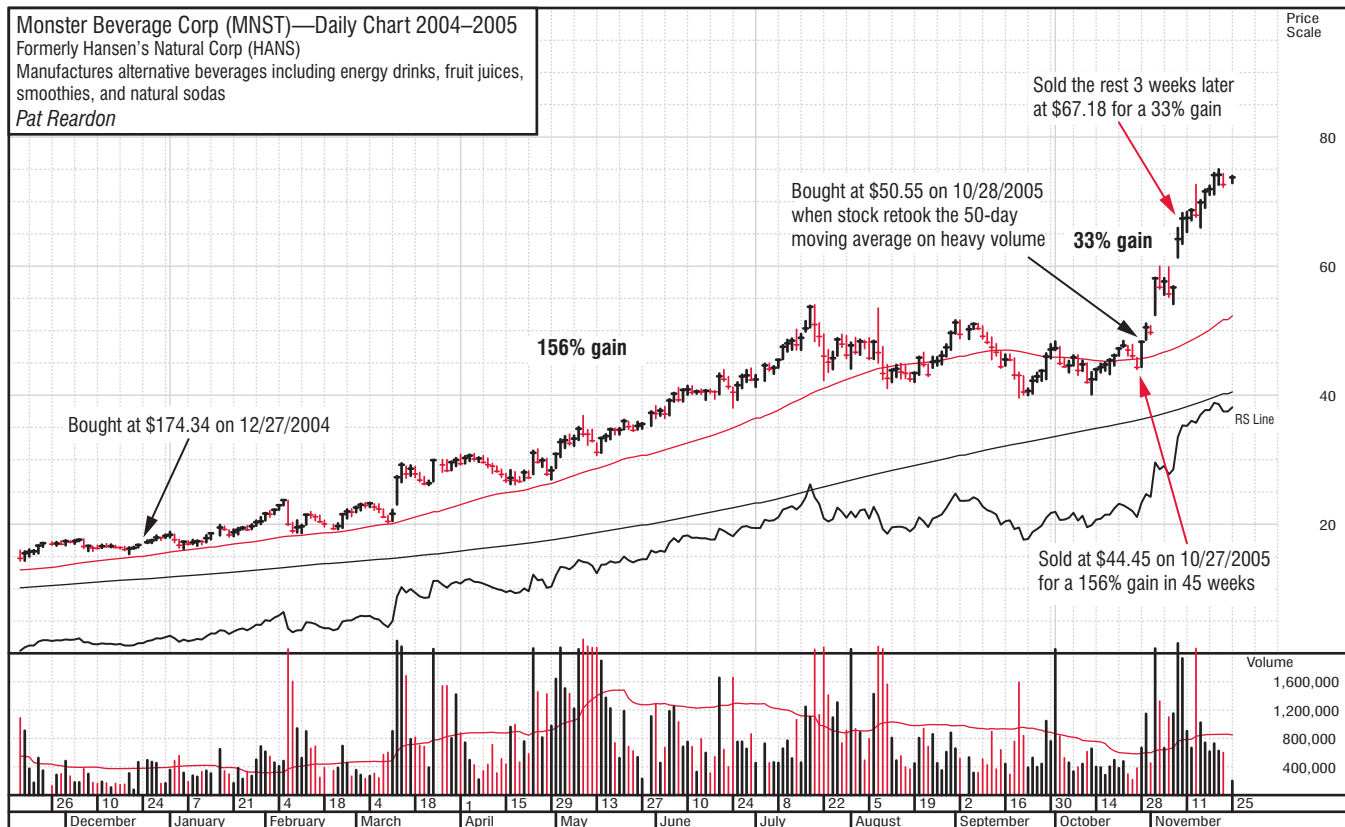
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Monster Beverage Corp (MNST)—Daily Chart 2004–2005

Formerly Hansen's Natural Corp (HANS)

Manufactures alternative beverages including energy drinks, fruit juices, smoothies, and natural sodas

Pat Reardon



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The company had double digit earnings and sales growth as well as an innovative product, the Keurig Brewer, which makes individual cups of gourmet coffee. Dave bought the stock as it broke out of a classic cup-with-handle base pattern in March 2009, just as a new bull market was beginning.

“This was a very easy position to hold,” he says. “Six weeks later, I was rewarded with a huge payoff. Along with a great earnings report, the company announced that their K-Cups would be available in Walmart prior to Mother’s Day. The stock rocketed 37% on the announcement. Volume was 832% above average, showing enormous buying from professional investors.

“I hadn’t faced a huge gap-up move when I already had an established position in a stock for a long time. I remember Charles Harris (portfolio manager for O’Neil Data Systems and instructor for IBD workshops) explaining in a seminar that one needs to hit the accelerator when you find a great stock.” Dave says he likes to refer to it as “lighting the cans,” which is fighter pilot terminology for igniting the afterburners. “So, due to the incredible gains made from the Walmart announcement to sell Green Mountain Coffee Roasters K-Cup products, I placed a market order to buy 25% more shares of the stock. By 11:30 p.m. that night, floating around on an aircraft carrier with a significant lag in the Internet, I realized that I had placed one of my best trades ever. Green Mountain Coffee Roasters closed that day 44% higher than the previous day.”

Dave sat with Green Mountain till mid July, eventually closing out a gain of 78%. “I decided to exit the position due to a breach of the 10-week moving average,” he says. “The stock recovered and went higher without me, but I was fine with locking in my gains.”

• KEY POINTS •

- Tune out the news; pay attention to what the market and leading stocks are actually doing.
- Look for stocks setting up in a base while the market is in a correction.

Take Most Profits at 20 to 25%

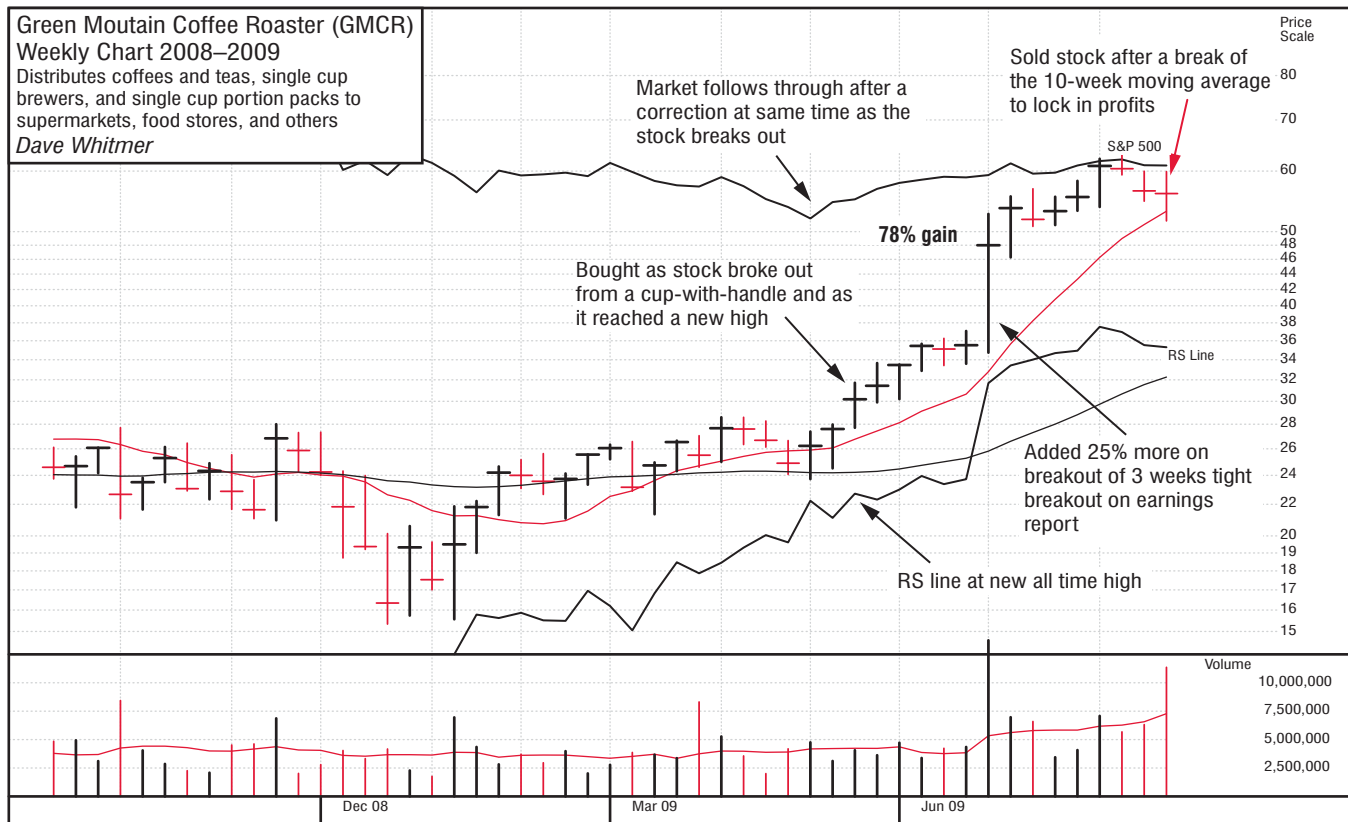
Lee Tanner said he had a moment of clarity that significantly improved his trading after attending IBD’s Level 4 workshop. The portfolio simulation

Green Mountain Coffee Roaster (GMCR)

Weekly Chart 2008–2009

Distributes coffees and teas, single cup brewers, and single cup portion packs to supermarkets, food stores, and others

Dave Whitmer



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showed that most winning stocks should be sold after they are up 20 to 25%, because at that point, many stocks will pull back and form another base or area of consolidation or even top.

Lee tended to hold onto his stocks too long and gave back much of his gains prior to following this simple sell rule. Lee learned the only time you would hold onto a stock longer is if it makes a 20% move in 2 to 3 weeks after breaking out, in which case the stock must be held for at least 8 weeks. That's because market history shows that stocks like those tend to go on to make massive moves after moving higher so quickly.

One stock that evoked the 8-week hold rule for Lee was Crocs in 2007.

Lee says the market environment in recent years has not led to the "big trades" that previous markets offered, but he had a "barn burner" with Crocs in 2007, netting a gain of 140%.

Lee said he became aware of the stock because it appeared in an IBD *New America* article in October 2006. A few months after the stock made its IPO debut, it was mentioned in *The Big Picture* column and was a leader up in volume in the *Market Pulse* section of the paper.

"Before investing in the stock," says Lee, "I visited a local Macy's store and found that Crocs had its own special display section in the shoe department, so clearly the shoes were selling well."

• KEY POINTS •

- Sell most stocks for a 20 to 25% gain, unless they go up 20% in 2 to 3 weeks, in which case, hold for 8 weeks.
- Read *The New America* article to find potential winning IPOs.
- Visit a store and check out the merchandise a company is selling.

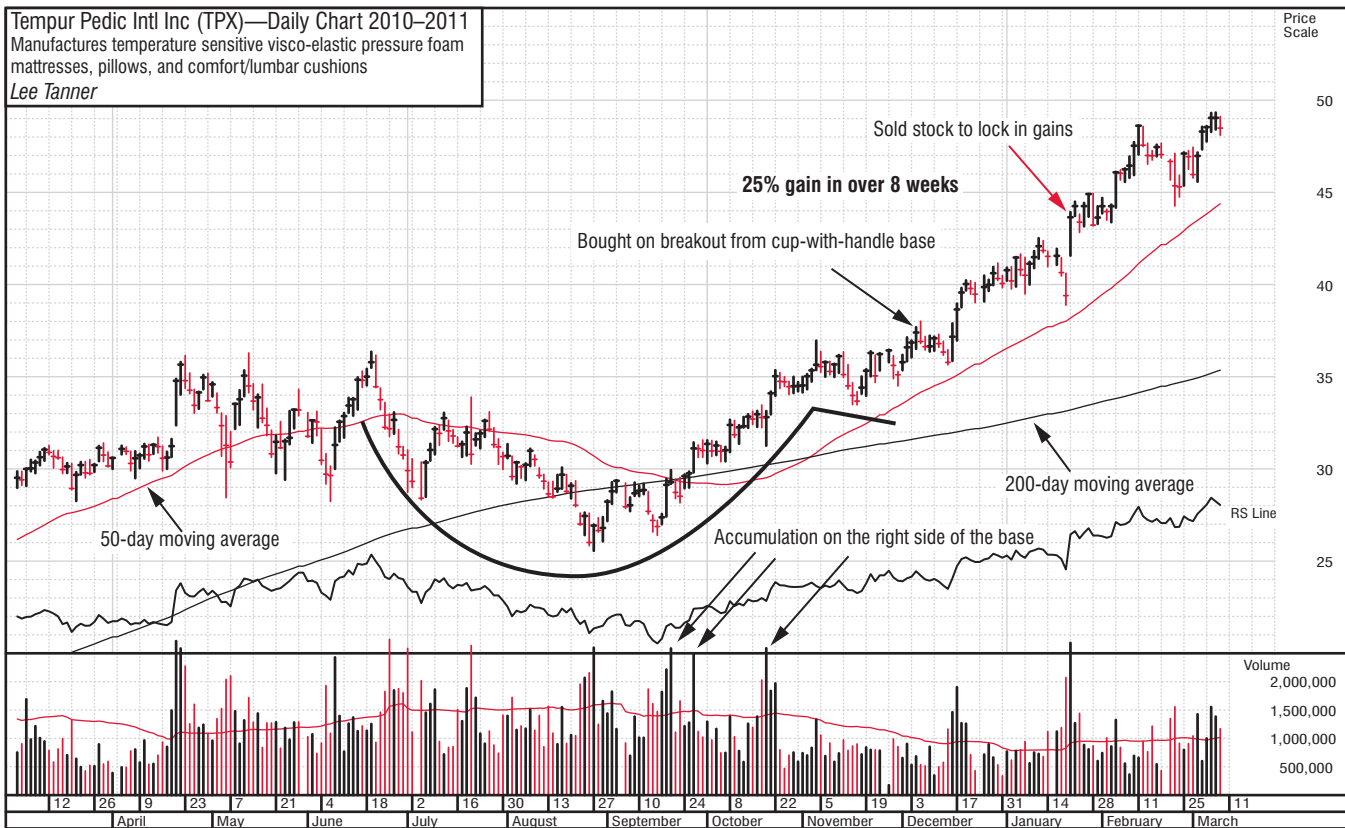
Learning to Profit from IPOs

In 2004, Mike Scott considered himself a "newbie" when it came to investing. He wanted to own Google but at the time didn't understand IPO bases, so he missed the September 2004 breakout. He bought the stock when it gapped up in April 2005. (A gap-up occurs when a stock makes a sharp move

Tempur Pedic Intl Inc (TPX)—Daily Chart 2010–2011

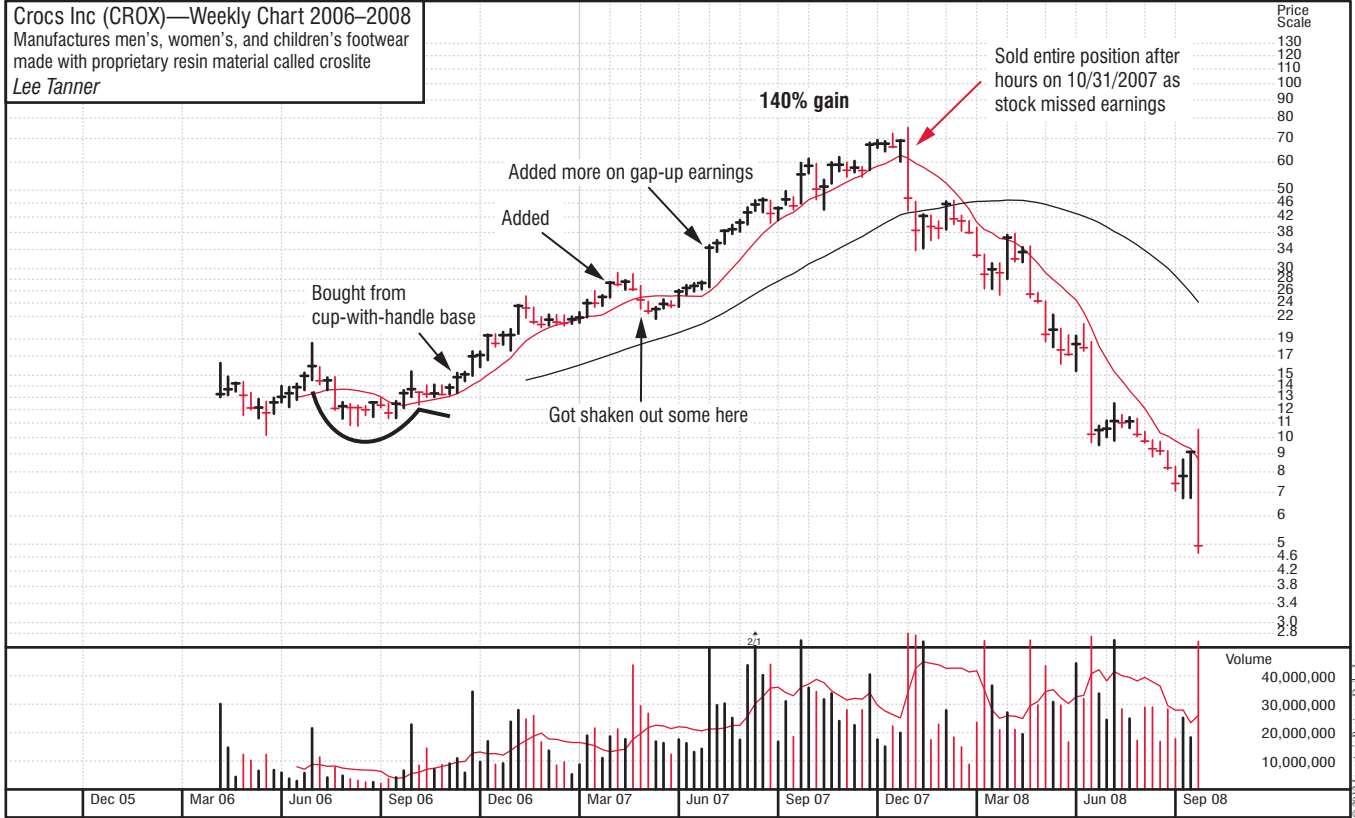
Manufactures temperature sensitive visco-elastic pressure foam mattresses, pillows, and comfort/lumbar cushions

Lee Tanner



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Crocs Inc (CROX)—Weekly Chart 2006–2008
 Manufactures men's, women's, and children's footwear made with proprietary resin material called croslite
Lee Tanner



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up in price. The heavy buying that causes the gap in price is usually the result of a strong earnings report or other positive news.) “Buying gap-ups at that time was scary to me,” says Mike. “Now I love them and often pay attention to stocks that gap up in price because I know that these stocks often end up going on to make big gains in the market.”

Mike was able to learn from that mistake and made some nice gains in another IPO, Michael Kors. “Having subsequently learned how to buy an IPO base correctly from my Google experience,” he says, “I didn’t falter when it came to the Michael Kors IPO. I bought the stock on January 17, 2012, at \$27.11. I had done my homework before the stock made its move and was waiting. Michael Kors was sponsored by three quality underwriters and had triple digit earnings and sales growth. The company’s products were popular and widely sold in department stores such as Macy’s. On January 17, Michael Kors had a gap-up, and I bought the stock. I added to my shares on three different occasions as the stock exhibited strength and moved higher, finally selling my position as the stock slid below the 10-day line for the first time in 8 weeks. I have learned that a stock that respects the 10-day moving average for a long time can be sold when it breaks that line.” Mike had an overall gain of 74% in Kors.

• KEY POINTS •

- Watch for quality IPOs as they break out of their first base.
- Consider selling if a stock has stayed above the 10-day line during its run, then falls below it.

If You Have Big Profits from a Bull Market— Sell if the Market Direction Changes

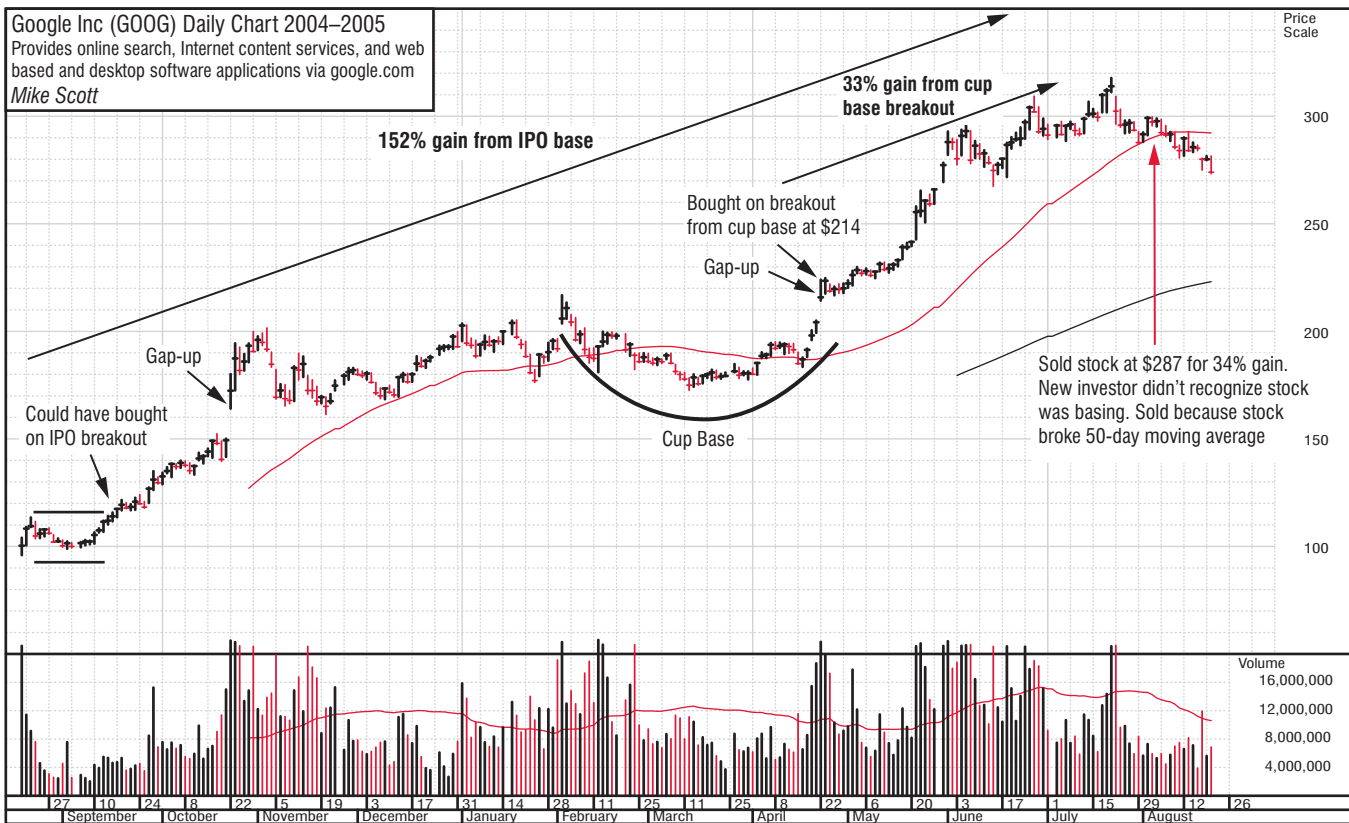
Anindo Majumdar was a software engineer for Cisco Systems in the mid-1990s. He said the company used to give employees stock options, so he became interested in seeing how the stock was performing. This was his first introduction to the stock market, and he viewed it as an exciting way to make some extra money.

Every 6 months or so, Cisco would give employees options, and since tech stocks were booming at the time, Anindo says it was pretty exciting to watch Cisco rocket higher.

Google Inc (GOOG) Daily Chart 2004–2005

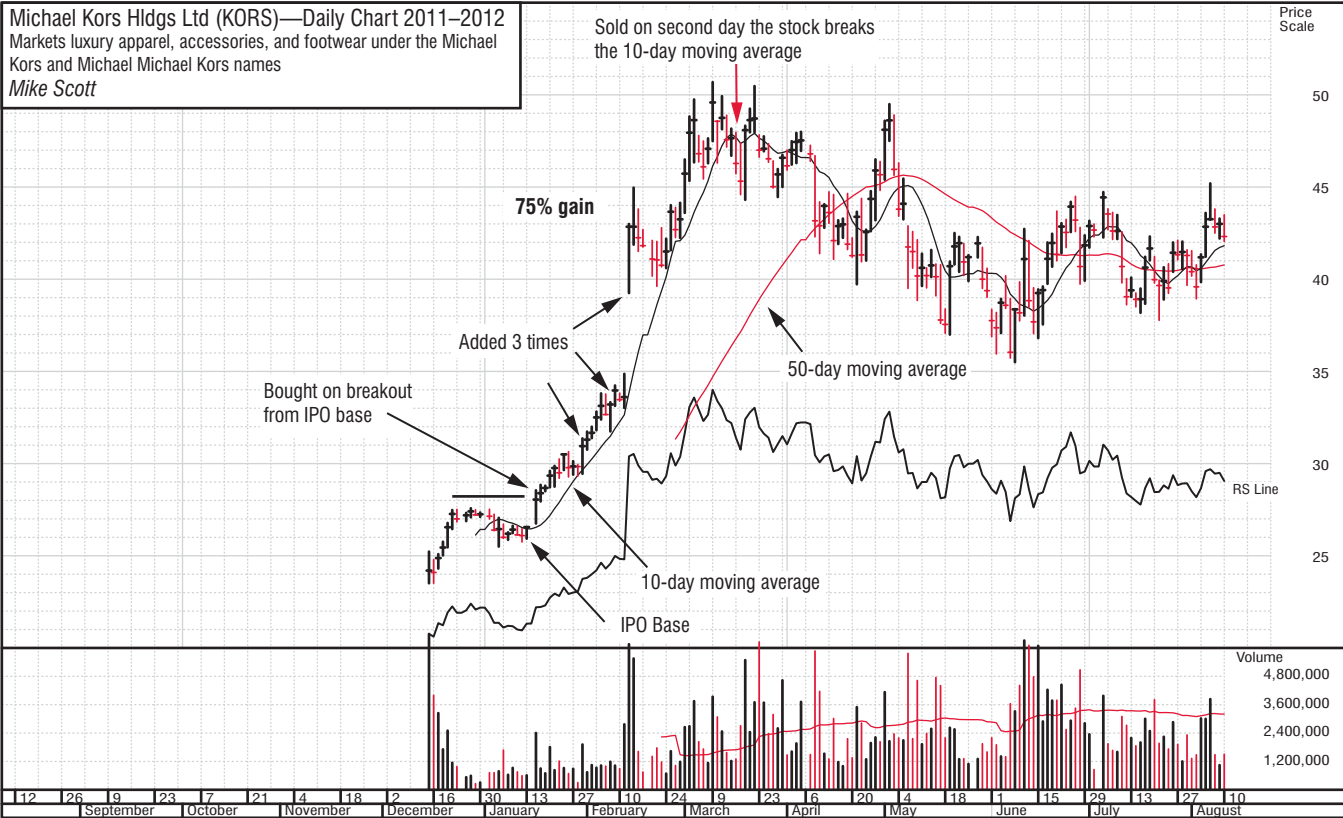
Provides online search, Internet content services, and web based and desktop software applications via google.com

Mike Scott



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Michael Kors Hldgs Ltd (KORS)—Daily Chart 2011–2012
Markets luxury apparel, accessories, and footwear under the Michael Kors and Michael Michael Kors names
Mike Scott



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Anindo's wife saw the enormous gains in his account and urged him to take some money out of the market and buy a house. Fortunately, he listened.

In 2000, because Anindo had not yet really learned anything about investing or the CAN SLIM strategy, he says, "I lost the rest of my gains in Cisco because I did not have any sell rules as the market collapsed."

But because he was able to buy a house using the profits he made in Cisco, Anindo was interested in learning more about growth stock investing.

In 2003 and 2004, he attended several of IBD's advanced workshops and ended up making a lot of money in the market. "It cemented in my mind that this system works very well in a bull market and to always pay attention to the overall market trend," he says.

As a result of his studies, Anindo notched gains of:

Taser. 90%

Taser. 72%

Google. 31%

Intuitive Surgical. 27%

Hansen's Natural. 38%

• KEY POINT •

- Lock in big gains if the market direction changes.

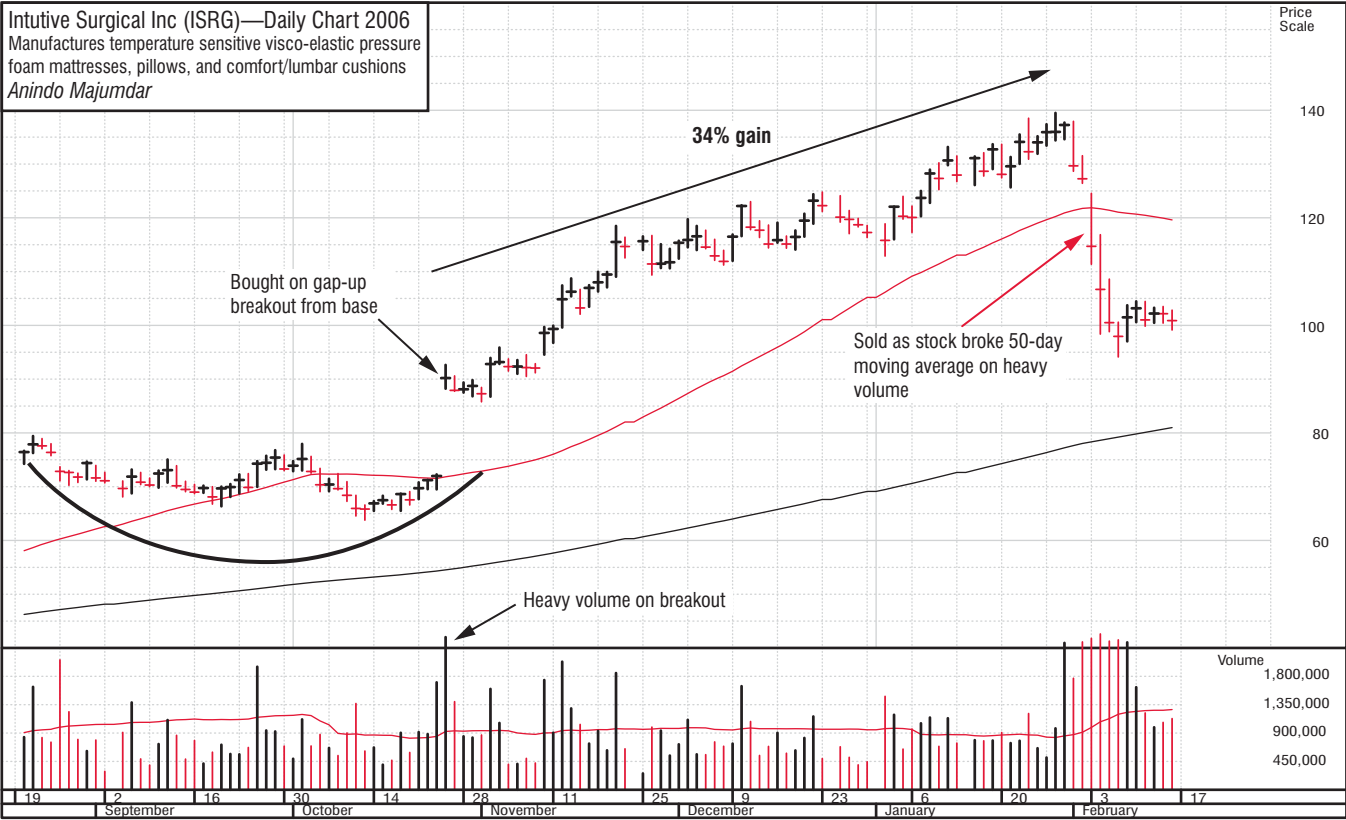
Stay Focused

Tom Ellis says the only investing publication he reads is *Investor's Business Daily*. He doesn't subscribe to any other newsletter or service and isn't interested in what stocks other people own. "I also made a rule not to share with other investors what stocks I am invested in or how much," he says. "I have learned this lesson the hard way. When I listen to the news or other people's opinions, it causes me to make mistakes and not follow my plan. I begin to second guess my decisions."

Because of this intensity of focus, Tom is able to consistently make 20 to 25% gains in the market using only IBD and MarketSmith to find stocks.

On January 4, 2012, Tom noticed Continental Resources in IBD's *Stock Spotlight*. It was also featured in the paper's *Industry Themes* article.

Intuitive Surgical Inc (ISRG)—Daily Chart 2006
 Manufactures temperature sensitive visco-elastic pressure
 foam mattresses, pillows, and comfort/lumbar cushions
Anindo Majumdar



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B4 THURSDAY, JANUARY 5, 2012

STOCK SPOTLIGHT

INVESTORS.COM

Fracking Oils
In Nice Spot, But
Regulators LoomBY PAUL WHITFIELD
INVESTOR'S BUSINESS DAILY

In the U.S. oil business nowadays, the optimistic camp rules.

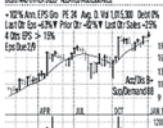
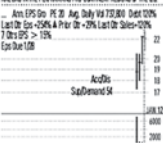
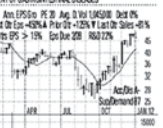
At a Q3 earnings call in November, Continental Resources' CEO Harold Hamm noted that "as they're saying in our business, the great oil fields keep getting better."

That's easy for Hamm to say because Continental has the largest acreage stake in the oil-rich Bakken region. But the regulatory environment tempers the optimism. On Tuesday, the American Petroleum Institute slammed the Obama administration's energy policy as "on the wrong track" and "incoherent."

Recently, new regulations on fracking—a deep drilling method—emerged on the state level. In mid-December, the Colorado Oil & Gas Conservation Commission reached a compromise on the disclosure of chemicals used in fracking. A lawyer for the oil industry called the compromise "workable." The rules take effect April 1.

Then on Tuesday, Arapahoe County commissioners backed a plan to do its own regulating of the oil and gas industry. It will instead rely on Colorado's state agency. The last thing the oil industry wants is a plethora of rules from every local entity.

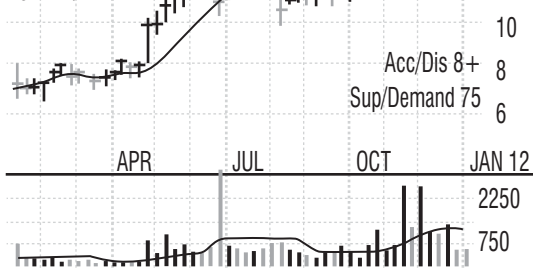
Continental's annual earnings have been strong but somewhat unstable. The five-year Earnings

HEALTHSTREAM INC (HSTM) Group 1 o\$17.39
99 Comp. Rating 78EPS RS99 ROE8% 16.5M Shares
PROVIDES WEB-BASED TRAINING SERVICES FOR HEALTHCARE ORGANIZATIONS AND PHARMACEUTICAL AND MEDICAL DEVICE COMPANIESSELECT COMFORT CORP (SCST) Group 11 o\$22.77
99 Comp. Rating 78EPS RS99 ROE12% 112.2M Shares
OPERATES 300 MEDICAL STORES OPERATING ALLEGRA PHARMASIES
BASED IN OREGON; SEE RELATED ACCOUNTSCONTINENTAL RES INC (CLSI) Group 29 o\$20.23
99 Comp. Rating 78EPS RS99 ROE12% 41.9M Shares
ENGAGED IN THE EXPLORATION AND PRODUCTION OF OIL AND GAS IN THE NORTH SOUTHERN REGION OF THE U.S.SPECTRUM PHARMACEUTICALS (SPPI) Group 9 o\$14.48
99 Comp. Rating 82EPS RS99 ROE12% 35.1M Shares
DEVELOPS INNOVATIVE THERAPIES WITH A FOCUS IN THE AREAS OF HEMATOLOGY-ONCOLOGY AND UROLOGYTEXAS CAPITAL BANKSHARES (TCBS) Group 27 o\$21.48
99 Comp. Rating 82EPS RS99 ROE12% 112.2M Shares
HOLDING CO FOR TEXAS CAPITAL BANK OPERATING VIA 100 OFFICES IN DALLAS, BEAUMONT AND 5 OTHER CITIESLARGO PETROLEUM HOLDINGS LP (LPH) Group 29 o\$22.15
99 Comp. Rating 82EPS RS99 ROE12% 41.9M Shares
ENGAGED IN THE EXPLORATION AND PRODUCTION OF OIL AND GAS IN THE NORTH SOUTHERN REGION OF THE U.S.B-1 AEROSPACE INC (BANI) Group 38 o\$38.93
99 Comp. Rating 78EPS RS99 ROE12% 96.9M Shares
MANUFACTURES COMMERCIAL AIRCRAFT, ELEVATED AND BEVERLY STORAGE EQUIPMENT AND AEROSPACE FACTORIESUMPOHA HOLDINGS CORP (UMPH) Group 27 o\$21.48
99 Comp. Rating 82EPS RS99 ROE12% 112.2M Shares
HOLDING COMPANY FOR UMPOHA BANK OPERATING VIA 100 OFFICES IN DALLAS, BEAUMONT AND 5 OTHER CITIESATLAS PIPELINE PARTNERS LP (APL) Group 4 o\$38.93
99 Comp. Rating 82EPS RS99 ROE12% 41.9M Shares
M-F ENGAGED IN THE EXPLORATION, PRODUCTION, TRANSPORTATION AND TRANSMISSION OF NATURAL GAS IN THE U.S.DEALERTERAC HOLDINGS INC (DHND) Group 2 o\$27.13
99 Comp. Rating 82EPS RS99 ROE12% 30.2M Shares
PROVIDES SOFTWARE AND SERVICES THAT UNAMBIGUOUSLY DEALERS WITH FINANCIAL INSTITUTIONS AND OTHER REPUTABLE AGENCIESSALUR PHARMACEUTICALS (SLUP) Group 13 o\$46.38
99 Comp. Rating 82EPS RS99 ROE12% 112.2M Shares
DEVELOPS AND MANUFACTURES PRESCRIPTION DRUGS FOR THE TREATMENT OF GASTROINTESTINAL DISEASESENTERPRISE PRODUCTS PARTNERS LP (EP) Group 4 o\$38.93
99 Comp. Rating 82EPS RS99 ROE12% 41.9M Shares
M-F ENGAGED IN THE EXPLORATION, PRODUCTION, TRANSPORTATION AND TRANSMISSION OF NATURAL GAS IN THE U.S.

Enlarged Stock Spotlight Chart

COMPANY XYZ (XYZ) Group1 o\$17.39
99 Comp. Rating 98EPS RS99 ROE8% 16.5M Shares
PROVIDES WEB-BASED TRAINING SERVICES FOR HEALTHCARE ORGANIZATIONS AND PHARMACEUTICAL AND MEDICAL DEVICE COMPANIES

+25% Ann. EPS Gro PE 62 Avg. Daily Vol 269,200 Debt 0%
Last Qtr Eps +100% ▲ Prior Qtr +33% ▼ Last Qtr Sales +24%
3 Qtrs EPS > 19%
Eps Due 2/22
R&D 11%



That same day, the stock was added to Leaderboard, with a chart annotation showing a cup-with-handle base and a potential buy point of \$73.08.

On January 5, Continental Resources broke out of its base pattern on volume that was 78% above average. Tom bought the stock and sold it 7 weeks later with a 25% gain.

Some of Tom's other successful trades in 2012 were

Select Comfort. 25% gain in 7 weeks

Herbalife. 25% gain in 11 weeks

Priceline. 25% gain in 5 weeks

• KEY POINTS •

- Don't get confused by reading too many different investing publications.
- Use IBD and MarketSmith to find winning stocks.

Celebrating Gains, Reviewing Mistakes

Townsend Baldwin began reading IBD in 2004 and was successful using the CAN SLIM Investing System to trade in and out of Nutrisystem, the maker of prepackaged diet products.

He first purchased Nutrisystem in July 2005 when he saw the stock hitting new price highs and sold when the stock made a 20% gain. Later that same year, after the stock came out of a cup-shaped base, Townsend bought Nutrisystem again, netting a 25% gain. He had enough capital invested in the stock to buy an apartment in New York City with the profits, so these two trades were very exciting and rewarding. But as Townsend looks back on the trades, he says he realizes that he missed out on even bigger gains. From his first purchase in July until the end of the year in 2005, Nutrisystem produced a 214% gain. Townsend had not yet learned how to handle a big winner.

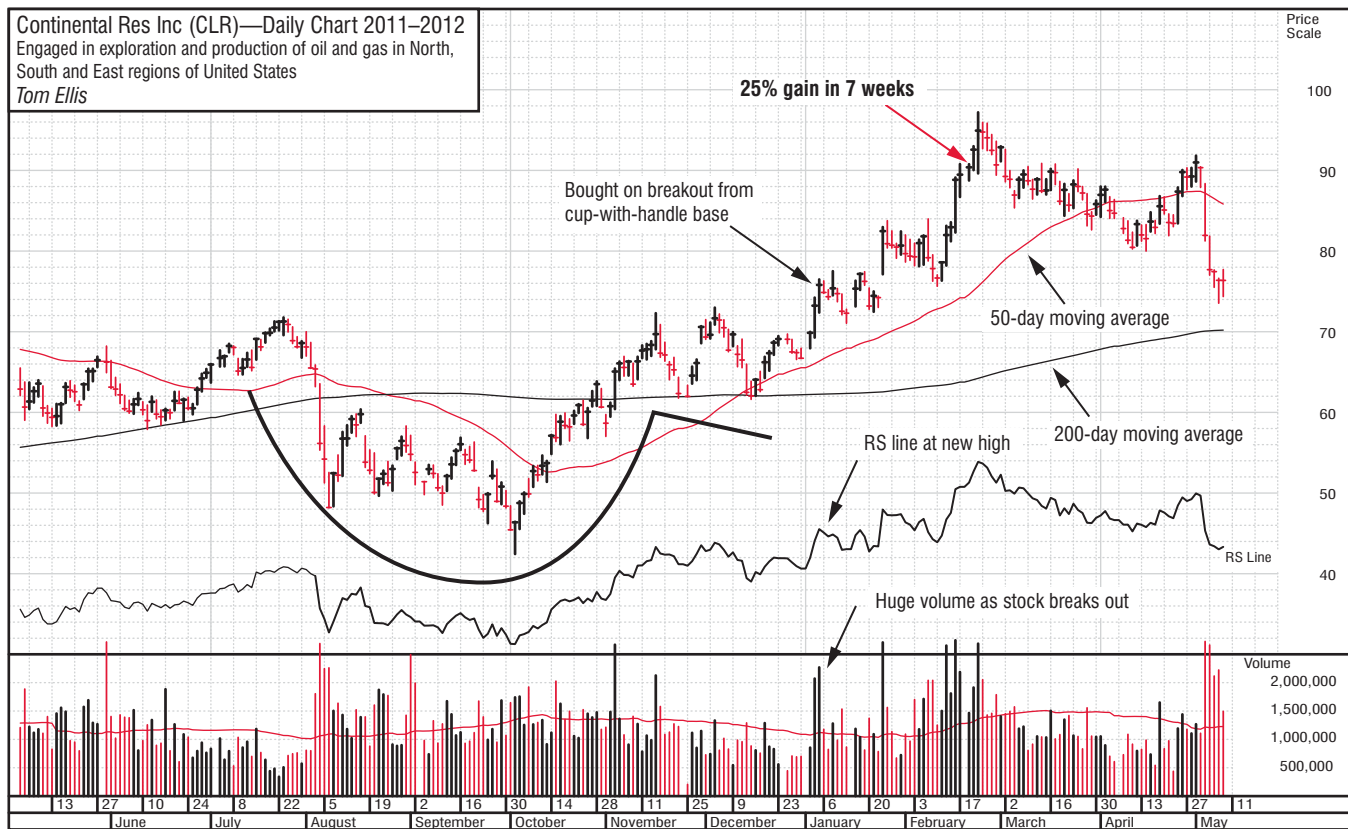
From October 2004 through December 2005, Nutrisystem made a 2,100% move.

The company came public in 2000, but what was *new* about the company in 2004 and 2005, the "N" in CAN SLIM, was that Nutrisystem had *new* management and had found a *new* way to sell more of their products through heavy marketing, such as selling on the cable-shopping network QVC.

Continental Res Inc (CLR)—Daily Chart 2011–2012

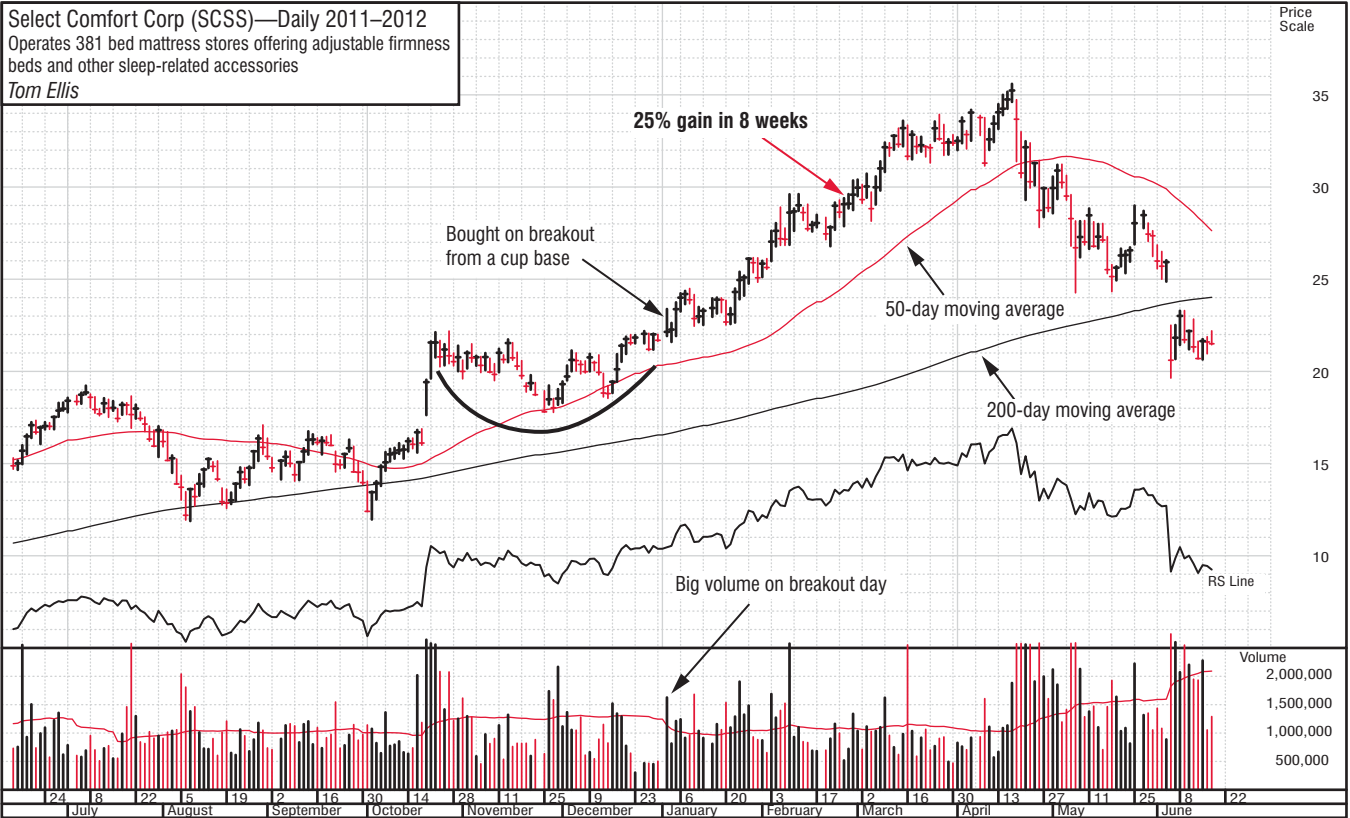
Engaged in exploration and production of oil and gas in North, South and East regions of United States

Tom Ellis

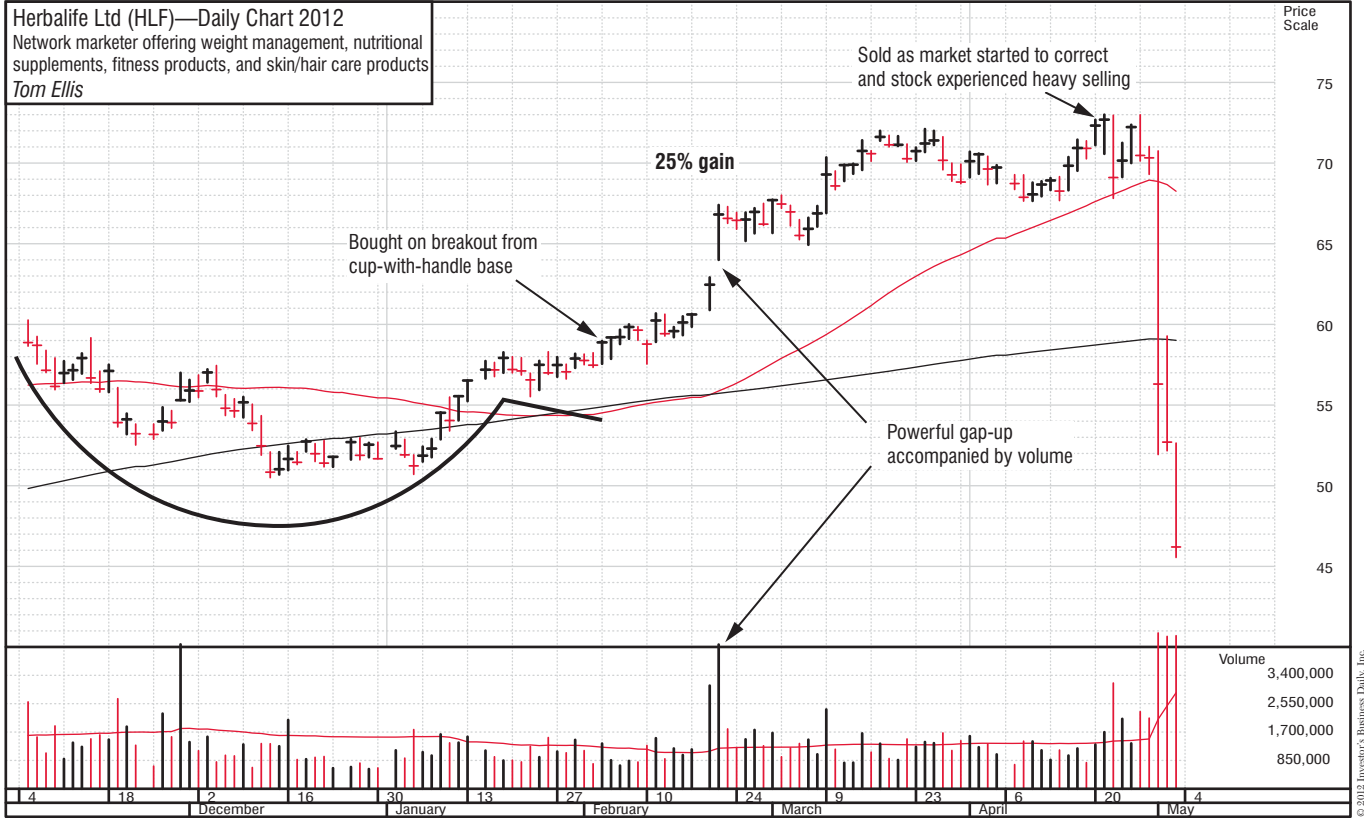


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Select Comfort Corp (SCSS)—Daily 2011–2012
 Operates 381 bed mattress stores offering adjustable firmness
 beds and other sleep-related accessories
 Tom Ellis



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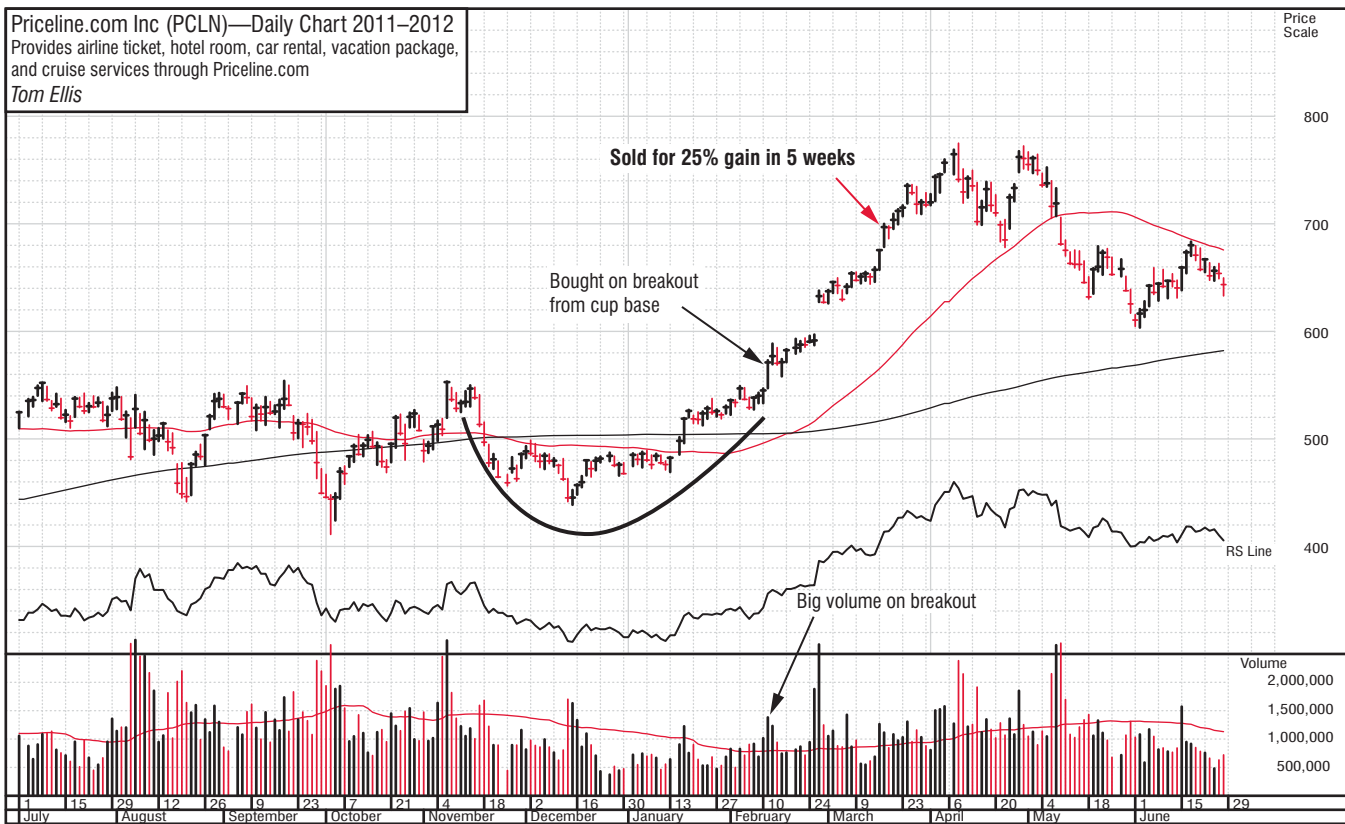


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Priceline.com Inc (PCLN)—Daily Chart 2011–2012

Provides airline ticket, hotel room, car rental, vacation package, and cruise services through Priceline.com

Tom Ellis



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This led to massive earnings acceleration and grabbed the attention of institutional investors, who bought shares of Nutrisystem, sending its stock price soaring.

In 2009, Townsend traded in and out of another stock, Baidu, which is the Google of China, netting gains of 40%, 15%, and 20%. Townsend said that reviewing his past trades gives him a chance to look at how he might have handled a stock differently. “Every trader makes mistakes,” says Townsend, “but the most important thing I learned from my experience with Baidu was that I did not exercise the patience needed to pull out the 1,000% gain that the stock made. A CAN SLIM trader could have made those enormous gains with Baidu if one bought at the beginning of the new bull market in March 2009 and held onto the stock as it made its tenfold move. My plan is to find the super stocks of the future and capture the truly big moves that these stocks make, using the CAN SLIM strategy.

“If an investor embraces keeping losses small, lets winners run, and follows clear investing rules, then one can’t help but be successful. Yet investing success takes hard work, understanding market psychology, and a willingness to study the overall market trend, but that’s the easy part after one makes the commitment.”

• KEY POINTS •

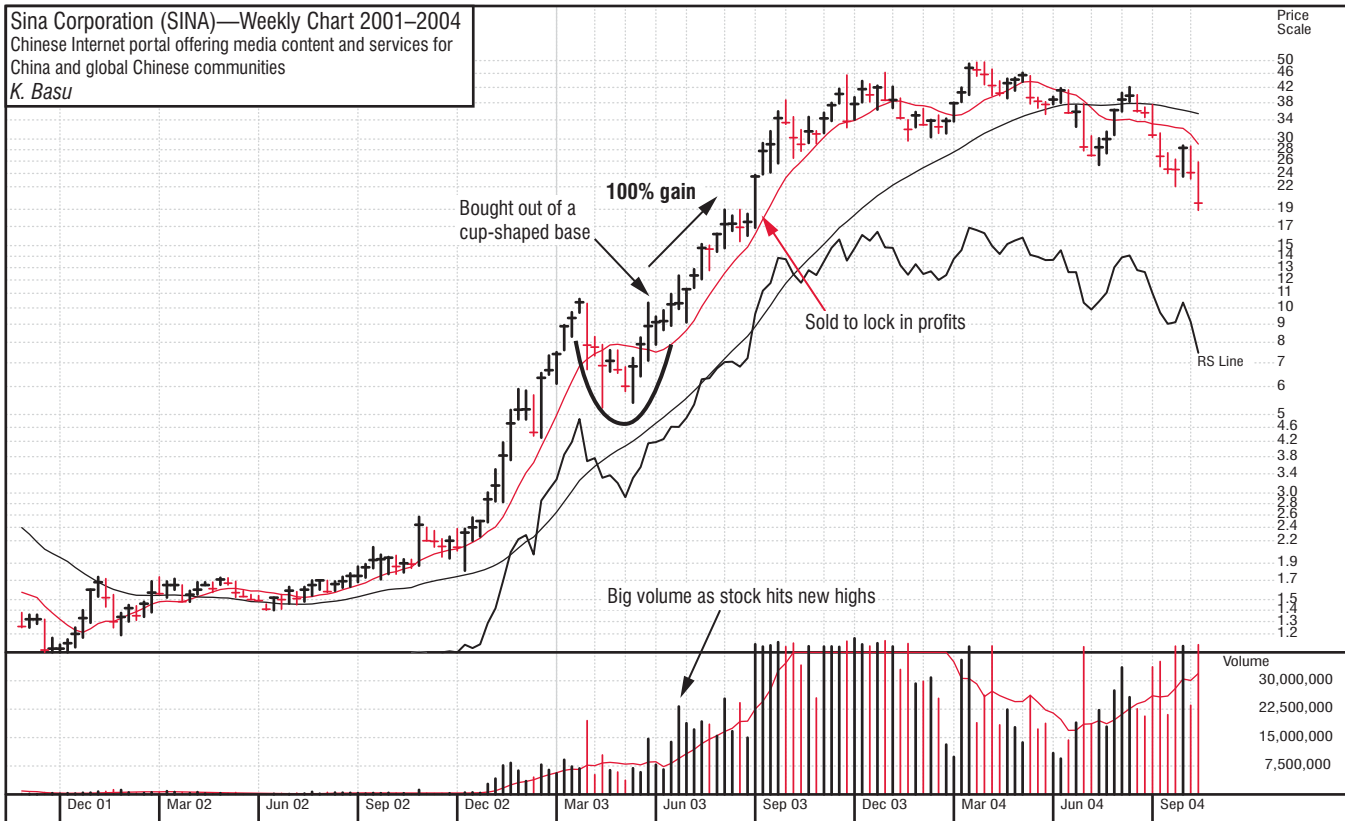
- Congratulate yourself on profitable trades.
- Review how you could have realized larger gains.

Treating Investing Like a Business

K. Basu was a “late bloomer to the dot.com rage” while he was in college. But he eventually started dabbling in the market and bought a stock that ran up 100% in a very short period of time. So he did what many young men would do: he took the profits and bought himself a car.

But when the tech bubble burst, he lost a lot of money in his account. At the time, he owned WorldCom, which eventually went bankrupt. He was very green and new to investing, so he didn’t have sell rules in place when the stock began to collapse.

Sina Corporation (SINA)—Weekly Chart 2001–2004
Chinese Internet portal offering media content and services for
China and global Chinese communities
K. Basu



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Learning to Invest Enough Capital in a Big Winner

In 2002, a colleague at work introduced him to IBD and Bill O'Neil's book *How to Make Money in Stocks*. In 2003, he bought Sina Corp, a Chinese Internet gaming company, and made a 100% gain. K. Basu thought this was great; the only problem was, he didn't have a large enough position, so his actualized gains were relatively small.

Then he attended several advanced IBD workshops as well as the New York City IBD Meetup Group and met other like-minded investors who helped him learn how to follow the market every day, and how to be active rather than passive in the market. He considers this a turning point in his investing, and he is grateful for meeting some terrific people from that IBD Meetup Group that would become his mentors. They really helped change his thinking about his overall investing strategy.

From then on, K. Basu would treat investing more like a job than a hobby. He took investing more seriously and started doing better in the market as a result.

His advice to other investors is simple: wait for a follow-through day, and scale in slowly to see if the market is working or not. Then take most profits at 20 to 25%. "If you do those two simple things," he says, "your yearly returns will probably be 25 to 50% in a decent market."

In terms of follow-through days, K. Basu learned to see how stocks are working a week or two into the new uptrend. "If stocks are acting well and moving higher," he says, "then the follow-through day will probably work. But if stocks are faltering and not holding onto their breakout moves, the follow-through day will probably fail."

If the market is in a correction, he keeps it simple and looks at the *IBD 50* to see what the top 10 stocks are doing. Are they setting up in bases, preparing to break out, or stalling? It's a quick and easy way to gauge the health of the overall market.

K. Basu encourages other people who have a full-time job and says, "You can invest even if you're busy. Do your homework on the weekend, find stocks that are setting up, then put in your buy-stop orders on Sunday night with your brokerage firm.

"That way, your trades can be executed or sold when you're busy at work and you don't have to worry during the day."

"If you do the numbers and understand the value of compounding the gains that you make in the market, and you keep your losses small and follow the CAN SLIM rules, you can do extremely well over the long term."

• KEY POINTS •

- Treat investing like a business.
- Wait for a follow-through day, and then scale in slowly.
- Look at the *IBD* 50's top 10 stocks during a correction to see if any are setting up in base patterns.
- Do homework over the weekend. Set trade triggers Sunday night through a brokerage account.

Paramjit Chumber

"I was living in England in the 1980s when Margaret Thatcher was the Prime Minister. At that time, a lot of the utility companies were being deregulated, and I did well investing with several of those companies as they began to become profitable. This was exciting and set a lifelong goal for me: I was going to become really good at investing no matter how long it took.

"In May 1999, I came to the U.S. but was busy getting settled and working a regular job, so I didn't become actively engaged in the markets until 2006. With my MBA background, I tried value investing, diversifying with 20 or more different stocks, bought some dividend stocks, and even tried to imitate some of the traders I saw on TV. I also tried options and swing trading. No matter which system I dabbled in, I watched my capital diminish."

"Through all of this, I realized you cannot rely on someone else's opinions; you must make your own decisions and be in control with a specific plan."

Paramjit became an *IBD* subscriber in July 2008, but this would prove to be a difficult time in the overall market.

He had a pivotal moment in 2011 when he saw Bill O'Neil speak to an *IBD* Meetup Group in Santa Monica, California. Bill mentioned Richard Wyckoff, a trader from the early 1900s who advocated controlling risks in any particular trade.

This changed Paramjit's outlook forever. He saw that trading needed to be treated like a business. From there, with his MBA background, he set forth a business plan with a set of rules that would include a monthly review of how he was doing.

He notes that sell rules are the most important and why it's critical not to get tied to a particular stock. "As the *IBD* saying goes, date the stock, don't

marry it. If you don't think you can get something out of the transaction, you have no business going in."

Paramjit encourages other investors: "Don't feel embarrassed if the trade goes against you. It could be a lack of experience or problems in the overall market. Everyone makes mistakes. Keep losses small; if you're determined, you'll work through it. And remember to take most gains between 20 to 25%."

• KEY POINTS •

- Create an investing business plan and review trades on a monthly basis.
- Everyone makes mistakes. Keep losses small.

Have a Written Trading Plan

Steve Power has been an IBD subscriber since 2005. Although he understood the system and made money over the years, he's had ups and downs as a trader. The main thing Steve struggled with is that he felt the need to always be in the market. Now he realizes that there are windows of opportunity to capitalize on winning stocks, and there are periods of time when it is best to step to the sidelines.

Steve didn't really have a strong plan of action until his friend Tom Ellis, an experienced CAN SLIM investor, suggested that he write down a specific trading plan and stick to a regular routine. Steve is a Senior Representative for a multinational company, so most of his research is done on the weekends.

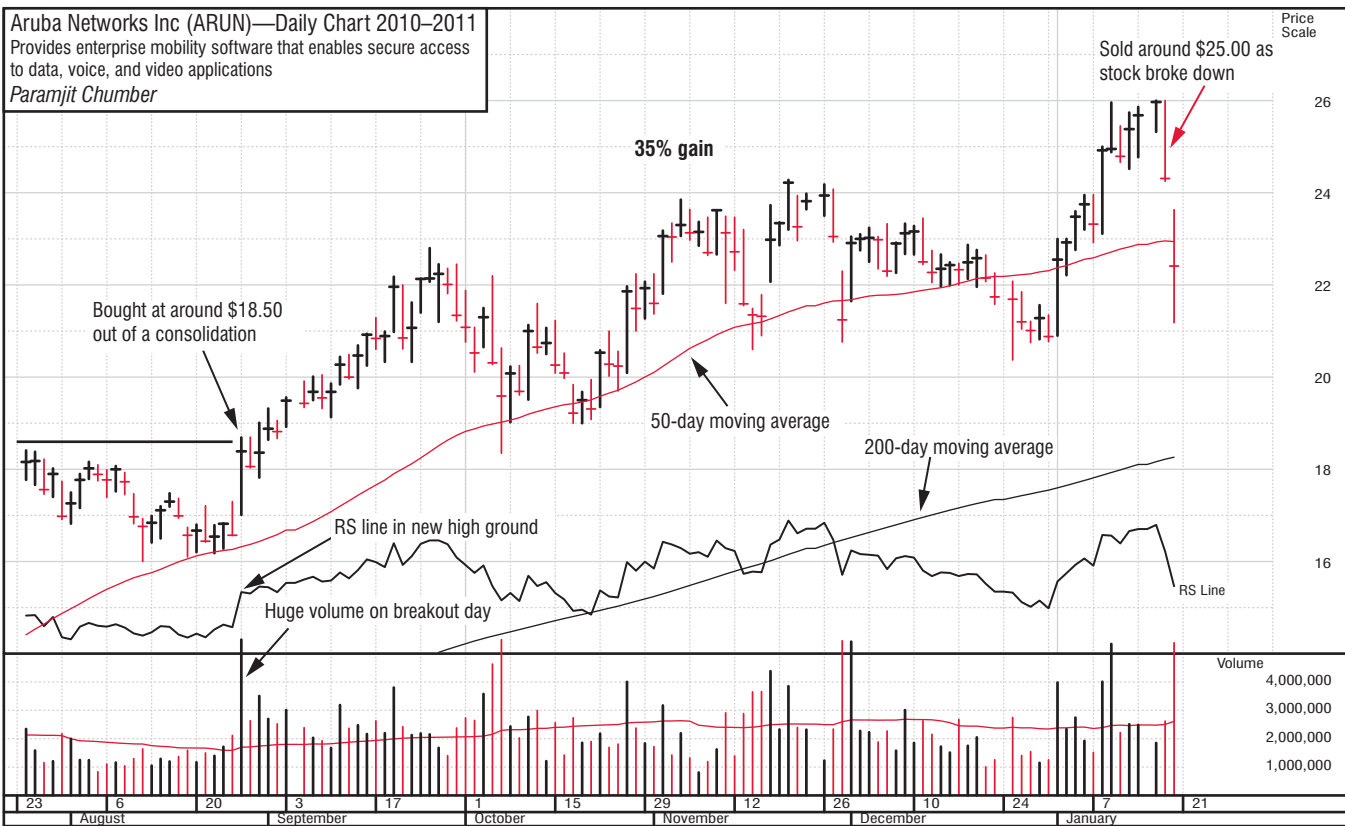
Steve's Weekend Routine

- 1. Watch list.** This list includes approximately 10 to 30 leading stocks that have the best fundamentals, such as double- or triple-digit earnings growth, a high return on equity, and increasing revenue growth. If this stock list becomes unmanageable because there are too many stocks on it, create a second list for stocks that don't quite meet the top fundamental criteria.
- 2. Buy list.** This is a list of 1 to 5 possible actionable stocks for the week. In some cases, buy triggers can be placed in advance of a breakout. In other

Aruba Networks Inc (ARUN)—Daily Chart 2010–2011

Provides enterprise mobility software that enables secure access to data, voice, and video applications

Paramjit Chumber



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cases, the buy may be dependent on further base development. Try to keep at least one stock on this list. The most difficult thing is to keep this list small when a bull market is raging. Remember to streamline the list down to the very best stocks that you can find.

- 3. Breakout list.** Keep track of stocks that break out from your watch list whether you bought them or not, and keep track of how they perform. This is a good indicator of overall market health.
- 4. Stops.** Update stops (the price at which a stock would be sold if the trade doesn't work out, no more than 7 to 8% below the purchase price) on the spreadsheet weekly.
- 5. New additions to watch list.** Download and review the *IBD 50* for new ideas twice a week. Run 1 to 2 MarketSmith screens looking for stocks with top earnings and sales.
- 6. Maintain records.** Write in a market journal at least once a week and every time a trade is made. Record trades in a portfolio performance spreadsheet, and keep this updated to determine market exposure, risk, profits, and so on.

Steve's Daily Routine

- 1.** Read *The Big Picture* column, and check the overall market trend.
- 2.** Check stock lists (watch list, buy list, breakout list).
- 3.** Record trades, and update portfolio of positions currently held.
- 4.** Reprioritize the list with potential buy points if watch list stocks are preparing to break out.
- 5.** Set buy or sell triggers with your broker if a new stock appears that you want to buy or if a stock that you own flashes a sell signal.
- 6.** Read IBD articles for new ideas.
- 7.** Write in a market journal every time a trade is made.

Steve says the system “works well when applied correctly. I try to make trading as mechanical as possible to take the emotions out of it.”

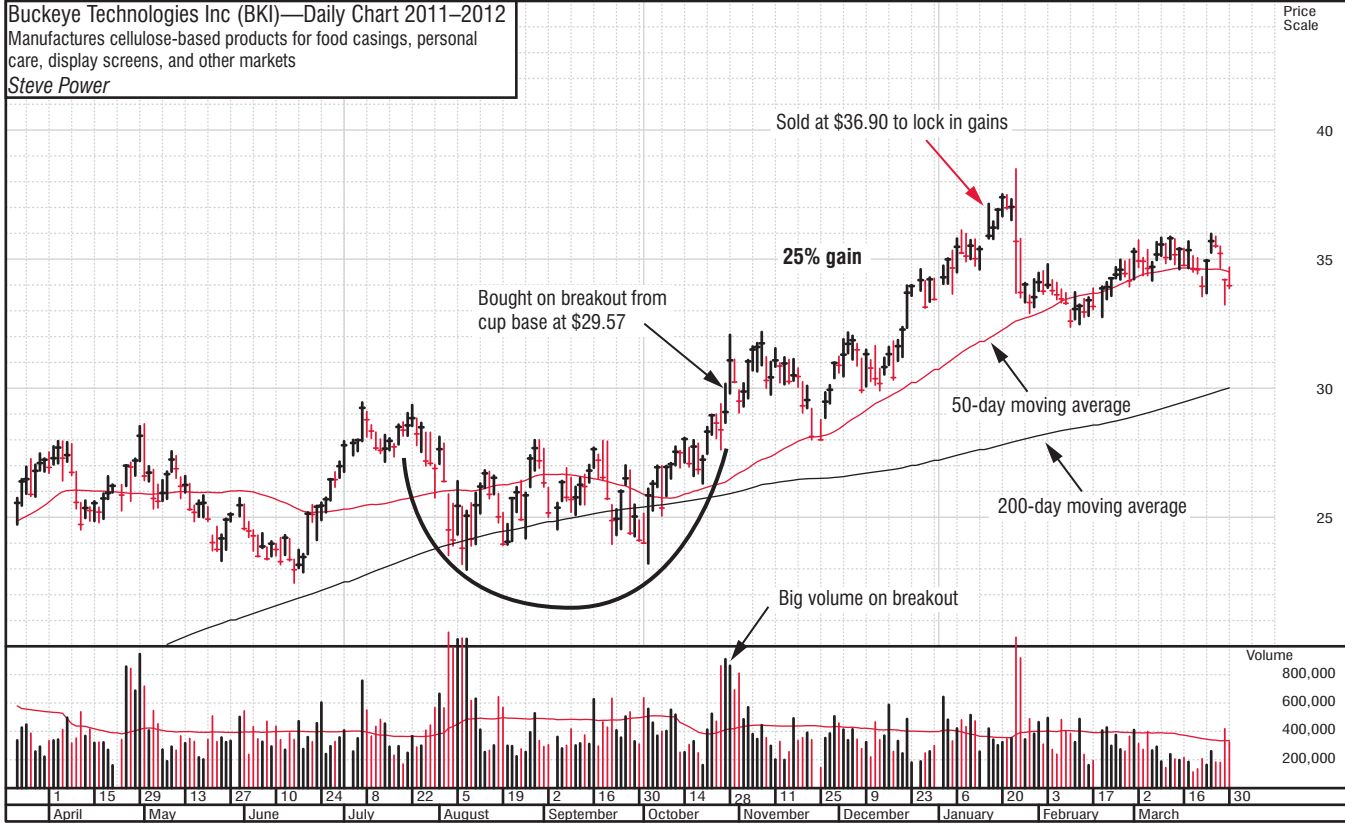
From Running a Pension Fund to Individual Investing

In the 1960s, Kent Damon worked as a security analyst for First City National Bank of New York, now known as City Bank. After that, Kent was

Buckeye Technologies Inc (BKI)—Daily Chart 2011–2012

Manufactures cellulose-based products for food casings, personal care, display screens, and other markets

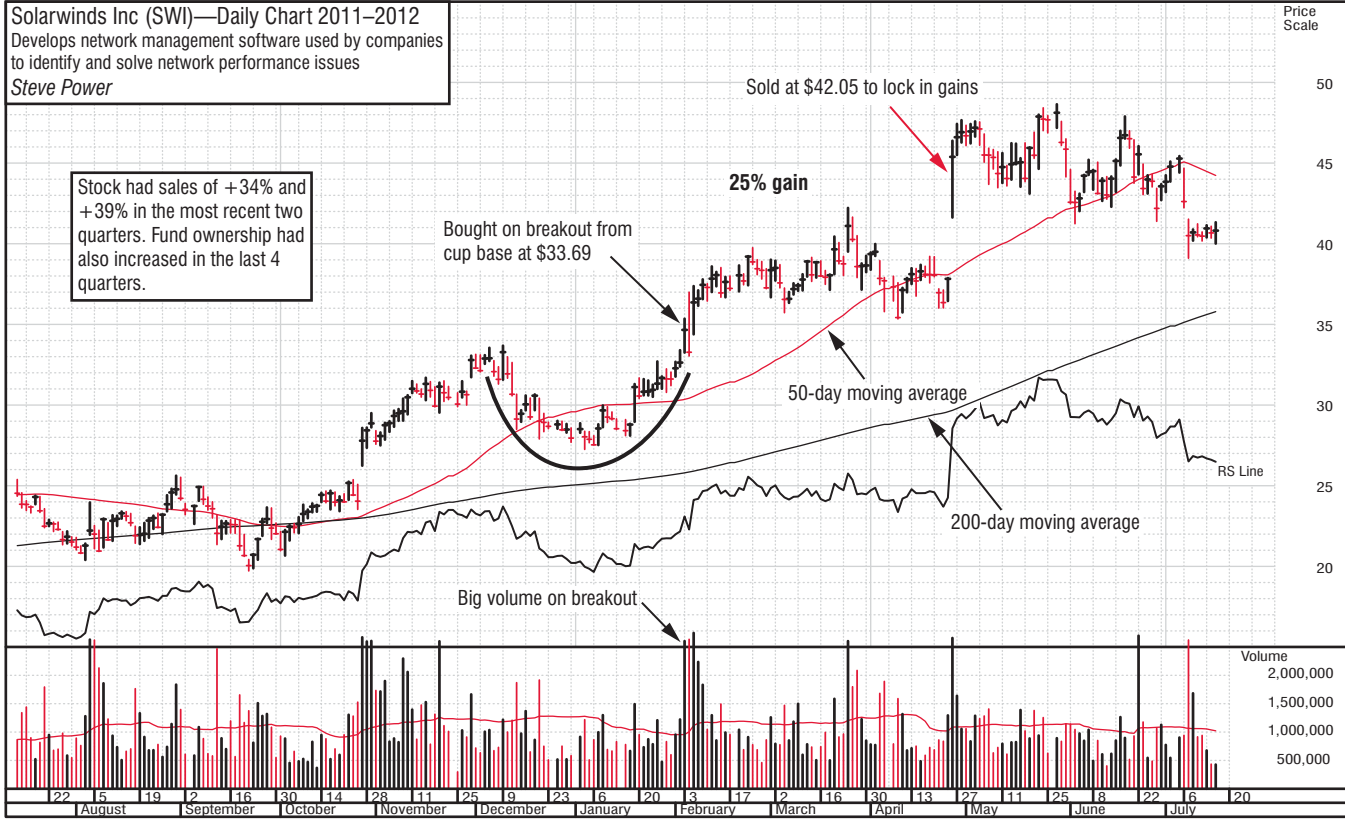
Steve Power



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Solarwinds Inc (SWI)—Daily Chart 2011–2012
 Develops network management software used by companies
 to identify and solve network performance issues
Steve Power

Stock had sales of +34% and
 +39% in the most recent two
 quarters. Fund ownership had
 also increased in the last 4
 quarters.



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an oil analyst for six years before moving to Atlantic Richfield, where he was in charge of Investor Relations. In 1995, he joined Arco and was appointed senior vice president responsible for overseeing its pension fund and all of the fund's investments.

Kent had a team of 30 analysts working for him, each of whom was designated a different amount of money as portfolio managers depending on their level of experience and performance.

The fund bought mostly growth stocks and was guided by instructional lessons on chart reading by Bill O'Neil, who would talk to Kent's team from time to time and help them learn what traits to look for in the market's biggest leaders.

For five years in a row, from 1985 to 1990, Arco performed in the top 10% of all U.S. pension funds while following many of the CAN SLIM Investing strategies.

In 1993, Kent was named president of Arco Asia Pacific and relocated to Hong Kong, where he lived for many years.

He retired and returned to the United States in 2001 and began subscribing to IBD. Kent feels he has come full circle from being a young investor in the 1960s who bought big name growth stocks, to overseeing Arco's pension fund, back to individual investing using the CAN SLIM strategies.

Kent says he "relies very heavily on IBD's *Big Picture* column to stay in step with the overall market direction. IBD puts all of the market and stock information in an easy, useful form with all the fundamental data listed."

He tends to hold big winners if he has a cushion and the fundamentals are still strong. Kent is willing to hold a stock through a normal pullback provided that the chart doesn't show heavy institutional selling. He bought Apple in late 2010 and owned it through September 2012.

Kent helps other investors as the IBD Meetup leader in Montecito, California, and says going through the lessons "is helpful and reminds me to stick to the rules also."

• KEY POINT •

- Hold big winners if you have a cushion as long as the stock is going through a normal correction and isn't showing signs of heavy institutional selling.

Don't Be Too Hard on Yourself and Learn Patience

In 1995, Jahandar Kakvand was doing some engineering research in the library and ran across *How to Make Money In Stocks* by accident. He became an avid IBD reader after reading the book and, as a result of his success in the market, quit his engineering job and became a full-time investor in 1999.

He dispels some of the myths that surround investing, one myth being that it's just like gambling. "Individual investors have a tremendous advantage," he says. "They can move in and out of the market much faster than institutional investors, and if you take the right precautions and follow some simple rules, you can do very well.

"Accept the fact that you're going to make a lot of mistakes, particularly if you're new to investing. In the beginning, it's like a baby learning to walk. You have to try and try again, no matter how many times you fall down. Be patient with yourself. If you are making progress with your positions, hang in there.

"Some of the key things to remember are not to try and fight the market. You must respect the market trend above everything else."

Jahandar had success with Baidu in 2007. "Back in 2007, IBD had been writing about the stock many times, which brought it to my attention. I bought the stock at \$132 in June 2007 and sold it in October 2007 at \$320, when the stock had a big reversal day on high volume, netting a 142% gain."

• KEY POINTS •

- Accept the fact that you're going to make a lot of mistakes.
- Be patient with yourself.
- Don't try and fight the market trend.
- Read IBD articles to find winning stocks.

Find a Community of Like-Minded Investors

Jerry Powell heard Bill O'Neil speak at an IBD Meetup event in Anaheim in 2011 and said it made a significant impact on his trading. "Bill laid everything out in a very logical way that made sense to me."

The CAN SLIM rules are something that appealed to Jerry, and he learned the importance of going to cash if the market was in a downtrend. Jerry says he also learned why “the buy and hold strategy will kill you.”

Jerry had been successful trading options but was concerned about his 401(k). When investing in his “nest egg for the future,” he uses the paper and Investors.com to locate potential big winners and invests in CAN SLIM stocks.

Jerry has learned to keep his losses small and sticks to the 7 to 8% sell rule without fail.

He bought Apple shortly after the follow-through day on December 21, 2011, knowing the importance of buying stocks after a follow-through day in order to capture the moves of the best performing stocks. He bought Apple at \$396 and sold April 11, 2012, at \$624, logging in a gain of 57%.

His strategy is simple: follow the overall trend of the market by reading *The Big Picture* column in IBD daily, look for the market's biggest leaders through the many features found in IBD, and buy them as they break out of price consolidations. Take most profits at 20 to 25%, and stay in touch with other investors to help discuss the general market as well as leading stocks.

Jerry started a Facebook trading group as a way of sharing information with other like-minded investors. He says that trading is a very isolating thing. “It's easy to get too elated or down on yourself with your trades. You need to communicate with other people to stay balanced.”

Jerry is also a member of the IBD Diamond Bar Meetup Group and says the quality of teaching and intelligent participation within the group has helped him solidify many of the CAN SLIM principles.

• KEY POINTS •

- Follow the overall market trend by reading *The Big Picture* column.
- Look for the market's biggest leaders through the many features in IBD.
- Join an IBD Meetup Group.

John Mackel

John is a lawyer and the leader of the Pasadena IBD Meetup Group, one of the most active IBD Meetups in the country. In order to keep the conversa-

tion going between monthly meetings, John formed a Google Group, which is basically a way for members to communicate with one another via e-mail through threaded conversations.

Meetup members can simultaneously e-mail everyone in the group and discuss the market or stocks. These e-mails get sent out to everyone in the group who opts to participate. John finds this a terrific way to update members about stocks that are breaking out or perhaps breaking down as well as answer questions from the group about stocks or the overall market. Other seasoned traders regularly contribute to the conversation to help newer investors engage and learn.

John also e-mails annotated charts of stocks that are setting up with comments concerning the stock's fundamentals or technical action. John says that teaching and helping other investors on a daily basis keeps him in touch with the market's current action as well as how the leaders are performing.

Before leading the IBD Pasadena Meetup group, John says he was "excited to find knowledgeable CAN SLIM traders at the Santa Monica IBD Meetup. During two years of attending these Meetups, I not only developed some great friendships but also honed my skills and increased confidence in my trading."

As a busy attorney, John says he sometimes misses a stock that is breaking out of a base pattern, but he realizes that a good stock will usually offer other entry points, like a pullback to the 10-week line. He also notes that in a good rally, there will usually be several quality stocks to buy, so if he misses one stock, there will be others breaking out. John usually owns no more than six stocks at a time and tries to narrow that down to the few that are performing the best.

"I find most of the stocks that I trade by reading IBD," he says. "As I'm reading through the paper, I keep MarketSmith open so I can study the chart of a stock that looks interesting."

John looks back fondly at the trade that got him excited about investing. "EMC, the computer data storage company, was my first big trade. When I look back, I realize how lucky I was to capture a 400% gain and yet how much I still had to learn.

"I first learned about the stock from an article in IBD and then met one of EMC's executives at a trade show who got me really excited about the company's growth potential.

"Not knowing much about sell rules, I didn't sell the stock as it topped in late 2000, but I had read in IBD that leaders were breaking down and distri-

bution days were increasing, so when EMC dove below the 200-day moving average, I sold my entire position.”

• KEY POINTS •

- Consider forming a Google group for e-mail discussions with other investors.
- Big winners will offer several entry points.

Switching Careers: Trading Full Time

Debra Kloote’s father first got her interested in the stock market in the 1990s. She started out investing in mutual funds but by 1999 was investing in individual stocks. Although Debra had some success, she wasn’t really following the market or stocks closely enough.

All of that changed when she found the Clearwater, Florida, IBD Meetup Group. She began attending the free monthly meetings and understood more about the paper and Investors.com. By this time, she was really ready to focus and learn.

In March 2011, an IBD Meetup leader from Naperville visited the Clearwater group and talked about switching careers. For years, Debra had been an accountant working in the corporate world, but she really wanted to spend more time trading and turn investing into a full-time job. This Meetup discussion made her realize that was a real possibility.

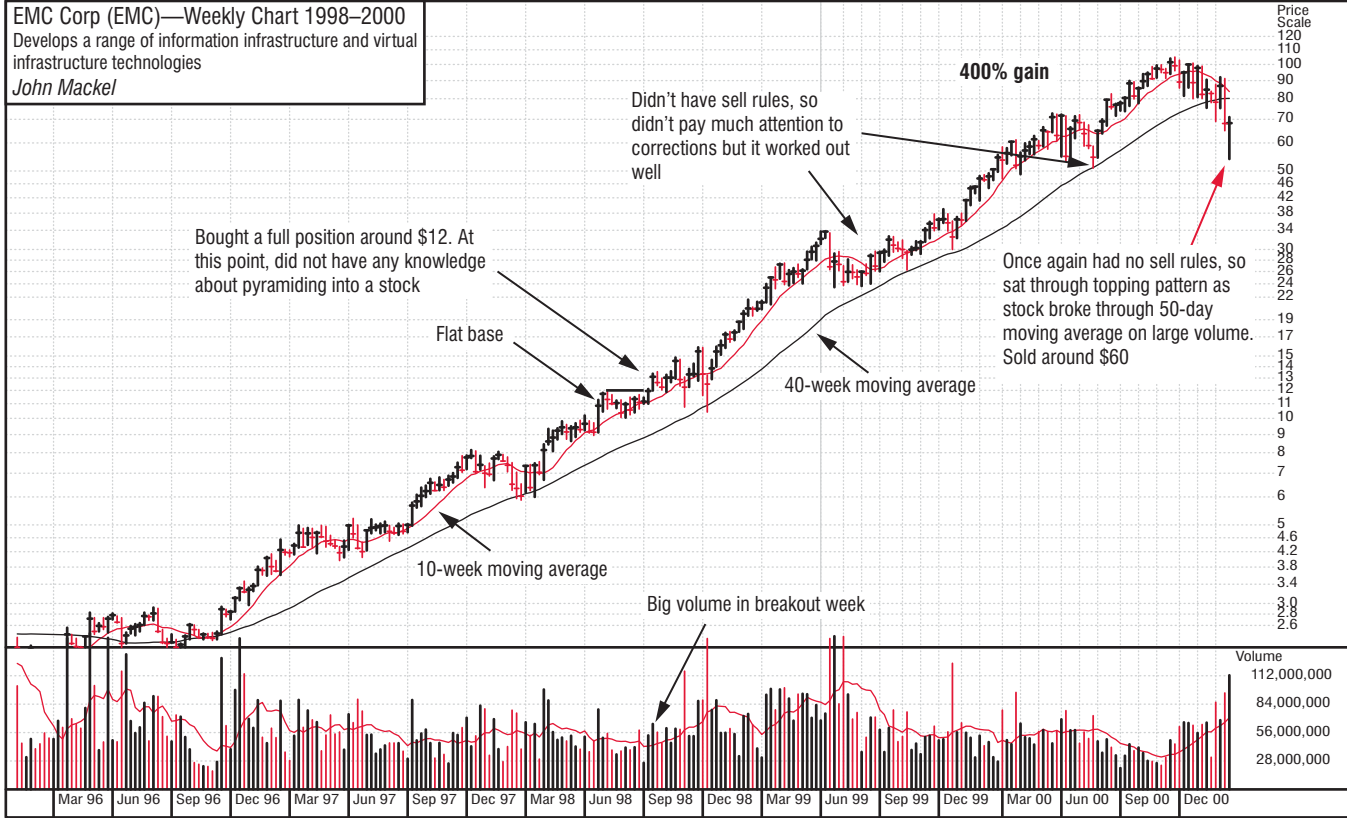
Later that year, Scott O’Neil, Bill O’Neil’s son and president of MarketSmith, spoke to the Clearwater IBD Meetup Group and said something that really resonated with Debra: “Don’t give the market your money unless it deserves it.”

Debra attended some of IBD’s advanced level workshops and began to do a post analysis of every trade she had made for the past three years. Doing this analysis really helped her learn where she needed to make improvements in her trading.

She wasn’t upset with her past trades but looked at them as valuable learning experiences. She says, “Mistakes equal learning. Reviewing what I did wrong keeps me from making the same mistakes again.”

Debra saw the market changing quickly in January 2012, and recognized the “window of opportunity was there with the beginning of a new uptrend.

EMC Corp (EMC)—Weekly Chart 1998–2000
 Develops a range of information infrastructure and virtual infrastructure technologies
John Mackel

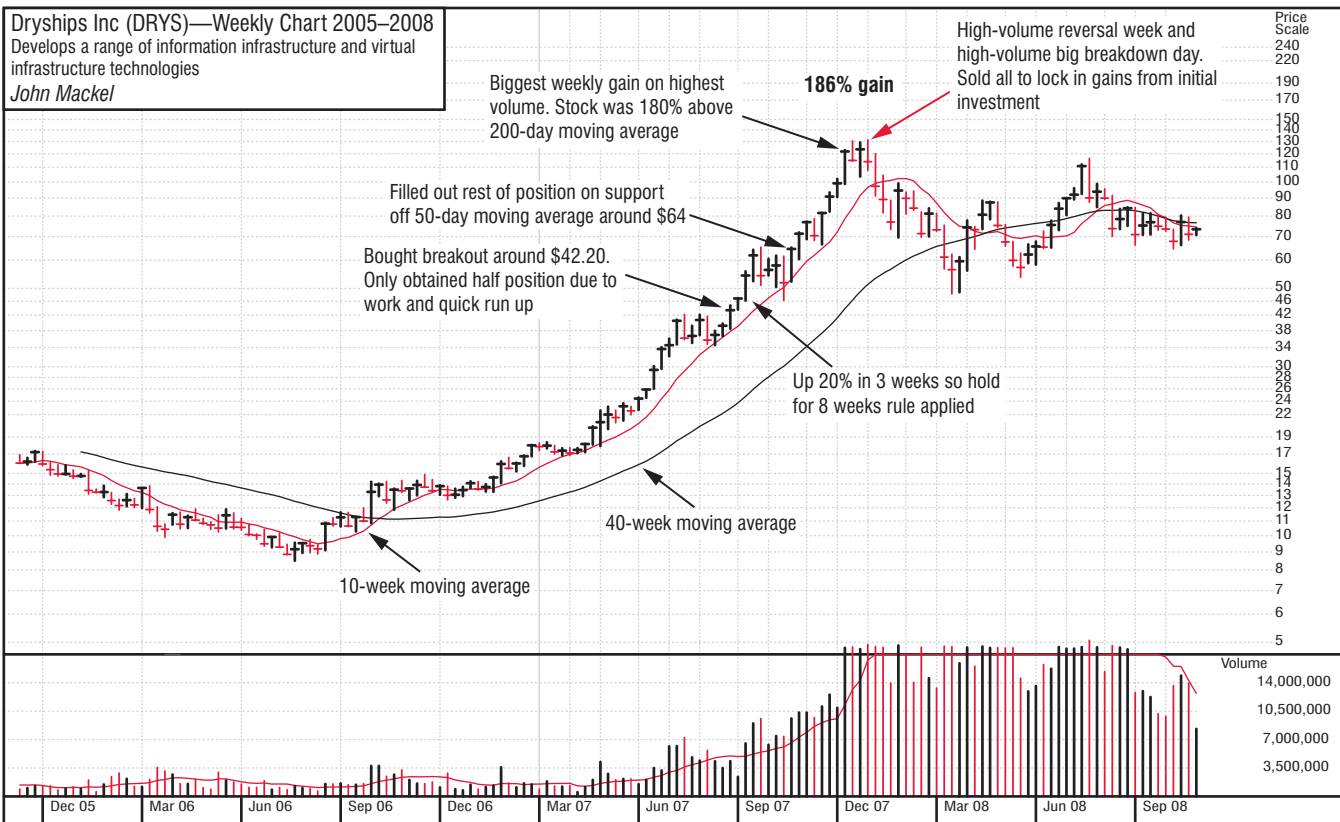


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Dryships Inc (DRYS)—Weekly Chart 2005–2008

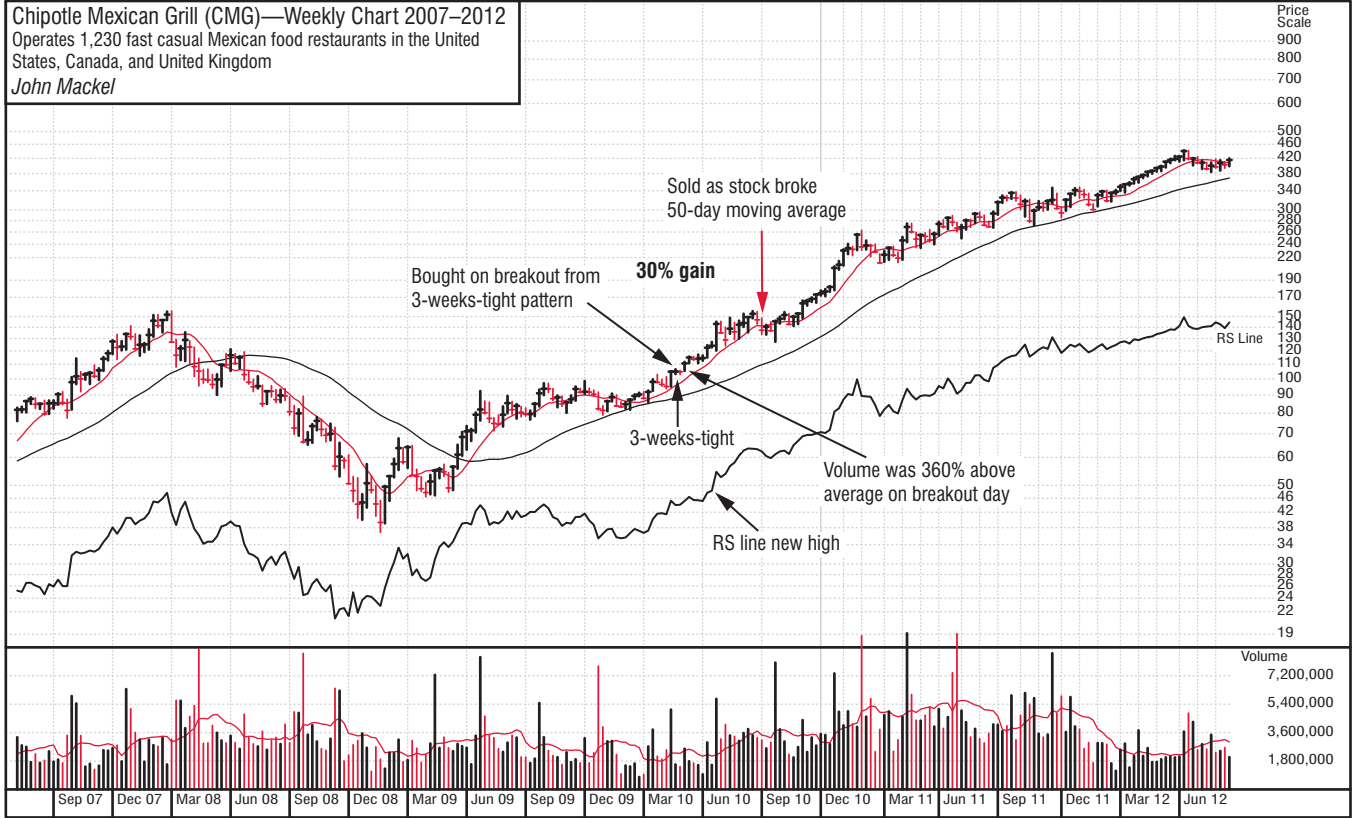
Develops a range of information infrastructure and virtual infrastructure technologies

John Mackel



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Chipotle Mexican Grill (CMG)—Weekly Chart 2007–2012
 Operates 1,230 fast casual Mexican food restaurants in the United States, Canada, and United Kingdom
John Mackel



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You must be ready to take advantage of leading stocks as they are breaking out, and the overall market is acting strong.” Debra started her journey of being a full-time investor.

She logged gains of:

Tractor Supply. 23% in 11 weeks

Apple. 33% in 13 weeks

MasterCard. 21% in 11 weeks

• KEY POINTS •

- Do a post analysis of trades, and find ways to improve.
- Always be ready for a new uptrend so you can capitalize on stocks that break out as a result.

Learning to Capture the Big Winners

Jeff Heimstaedt was in his senior year at Pepperdine University in Malibu when a fraternity brother invited him to his parent’s home for dinner. Jeff met a successful stock broker at the dinner who described the stock market as a great place for someone young to make money, if they were willing to work hard. The financial possibilities and the intellectual challenge appealed to Jeff, so shortly after college, he got a job with Merrill Lynch.

He became aware of IBD through a co-worker and read *How to Make Money in Stocks*, which introduced him to a fact-based investing system that made sense. Jeff said as well as reading the paper on a regular basis, he started subscribing to Daily Graphs (now MarketSmith) and would pick the chart book up at noon every Saturday as a way to find companies that were setting up in base patterns. “At the time,” he said, “there was no Internet, and very few charting services were around, so Daily Graphs was extraordinary.”

From 1998 to 1999, Jeff was buying a lot of the “hot” tech stocks like Yahoo as they broke out of price consolidations. His overall strategy was to buy stocks at the pivot, but if the trade went against him more than a point or two, he would sell them.

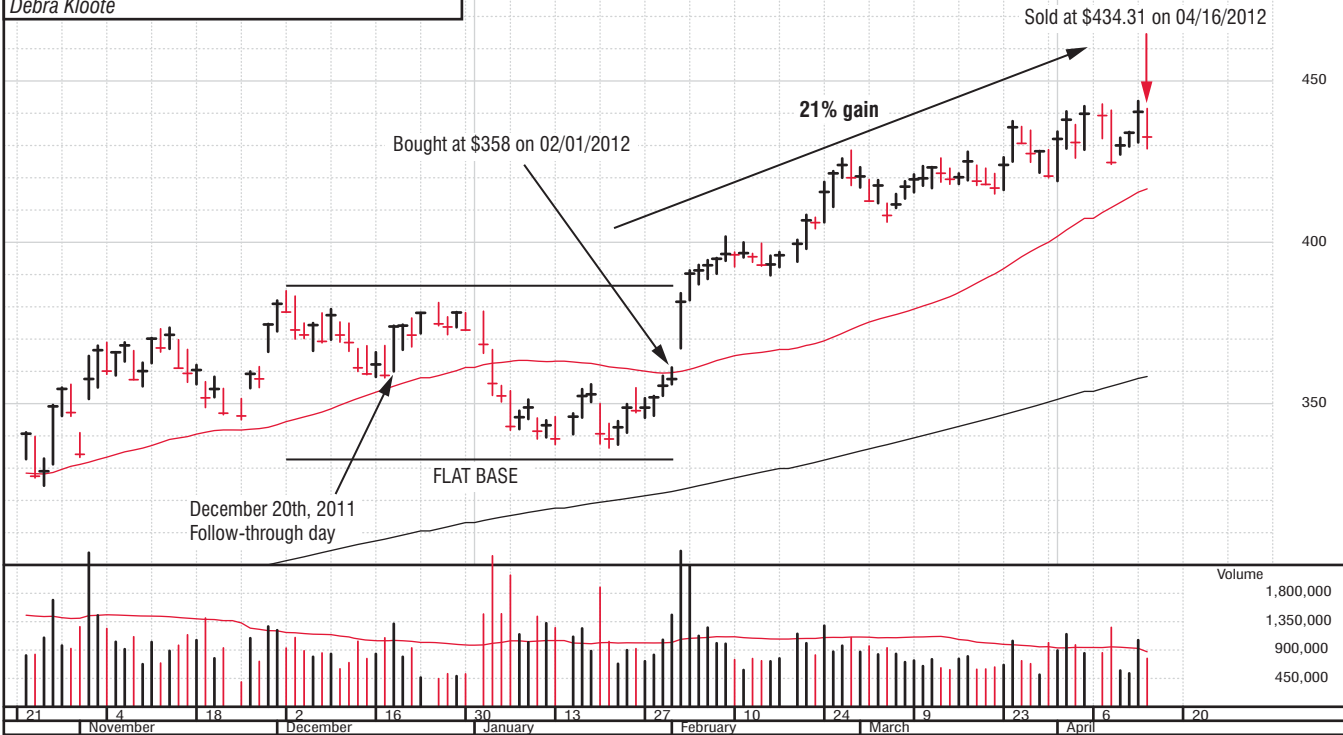
From January 1998 until February 2000, a period of 26 months, Jeff’s account increased over 750%.



Mastercard Inc CI A (MA)—Daily Chart 2011–2012

Provides global payment solutions in support of the credit and debit payment programs of financial institutions

Debra Kloote



Jeff's daily routine starts the night before, when he reads through *eIBD*, the digital version of the paper. He looks for ideas and focuses on companies that are different and stand out. He is very focused on the "N" in CAN SLIM and prefers newer companies with products or services that are in big demand by consumers.

During the trading session, Jeff uses a MarketSmith screen to track stocks that are up on volume and determines whether any of these stocks warrant immediate attention if they are breaking out of bases. On days when the market is in an uptrend but opens lower, he likes to see which stocks can buck the trend and turn up first. This has helped Jeff find several winners over the years.

As Jeff reflects on his learning curve as an investor, he mentions the first IBD workshop that he attended in 1990, and what an impact it made on him as well as how much it helped his trading. Through the years, Jeff has attended all of IBD's advanced workshops and says, "There have been so many important things that I have learned. Each workshop has its gems—the take home lessons—and I continue to learn."

"One of the biggest things I know now is that I did not exploit the big winners that came out of the 1980s and 1990s, such as Cisco Systems, Microsoft, Intel, Dell, and Home Depot. These were the change-your-life type of stocks, and although I netted some nice gains in the tech boom of the 1990s, I was too inexperienced as an investor to understand how to hold these stocks and capture their massive gains.

"But I am excited, because I believe that we are on the cusp of another secular bull market. Bill O'Neil and Chris Gessel discussed this possibility during a webinar in August 2012. I'm trying to adapt my trading style so that I can truly exploit the big stocks that will make enormous gains when this new era happens.

"I have been able to handle Apple reasonably well over the past three years, pyramiding my original position to over five times my initial purchase."

Some of Jeff's biggest winners over the years:

Crocs. 2007: 223% gain

Baidu. 2007: 61% gain

Apple. 2009–2012 (still holding the position mid-September): 444% gain

• KEY POINTS •

- During the trading session, look for stocks moving up on unusual volume using a MarketSmith screen or by checking *Stocks on the Move* at Investors.com.
- Focus on the “N” in CAN SLIM, newer companies with products or services that are in big demand by consumers.

Using IBD to Trade Options**Dave Whitmer**

Friday, June 29, 2007, Dave was standing in line for an iPhone. He purchased one of the last ones in a mall on the outskirts of Pittsburgh. “It was the first Apple product that I had ever bought,” Dave says. “I spent the entire weekend playing with it and could not believe how much better it was than the hype. I had the luxury of having Navy friends all over the country, and they told me that there were lines around the block at every Apple store. Because of my understanding of the ‘N’ in CAN SLIM, I knew that high demand for the iPhone would drive Apple’s earnings and sales higher and create institutional demand for the stock. So I decided to buy Apple July call options at the open on Monday for \$1.20 a share on its pullback to the 21-day moving average. I closed out the option position at \$9.00 per share as the stock went over \$140 in price. This was a 750% gain in just two and a half weeks. Conviction in the product gave me the confidence to execute this trade.”

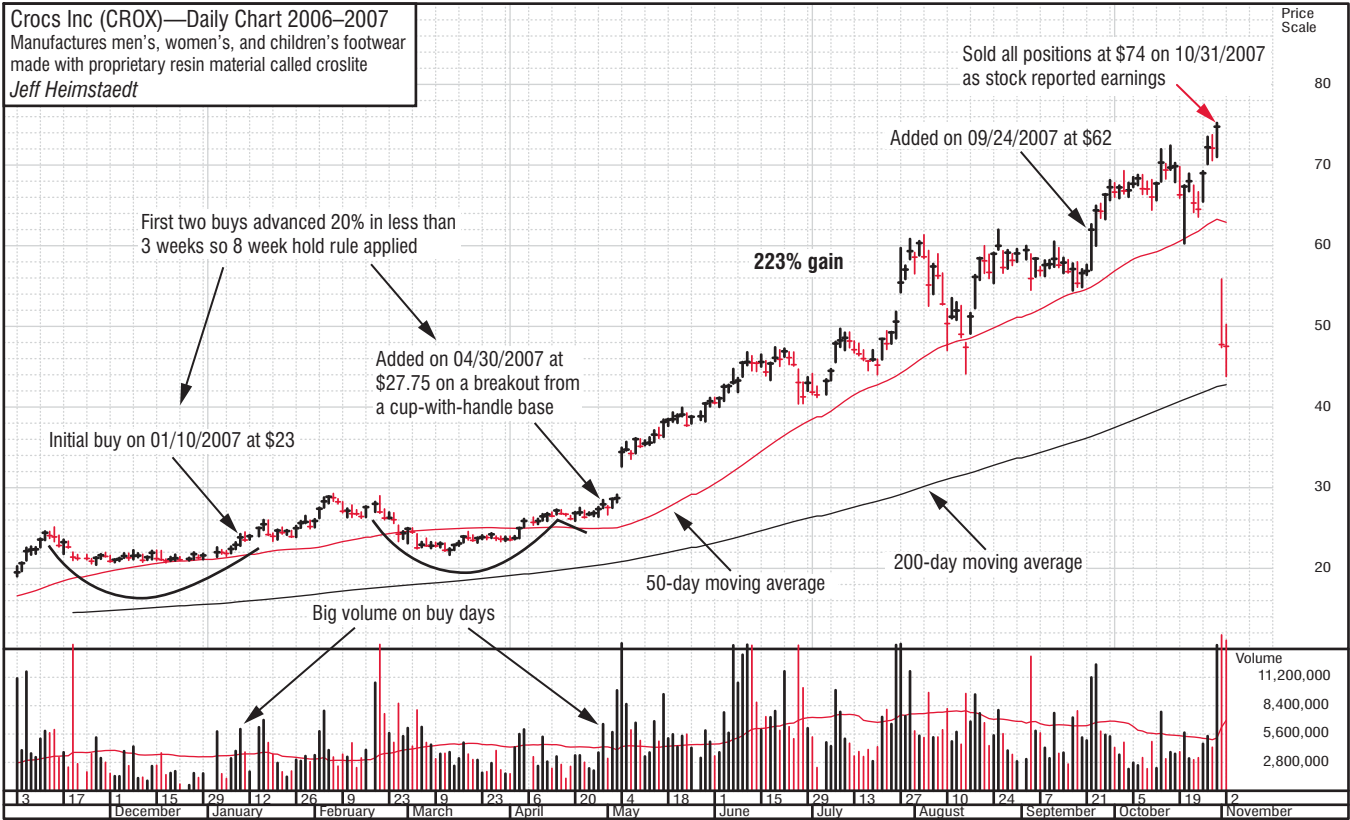
Jeannie McGrew

Jeannie reads IBD’s *Big Picture* column every day to make sure she stays in sync with the overall market trend. In December 2011, when the market began a new uptrend, Jeannie waited to see if the follow-through day would work and leading stocks were breaking out of sound base patterns. In January 2012, when she observed that the overall trend was acting strong and leading stocks were holding onto their gains, she bought SPY calls. Jeannie started off with \$300,000 in her account and increased it to \$410,000 in less than three months for a 36% gain. She says, “The most important thing is to manage your risks and keep your losses small.”

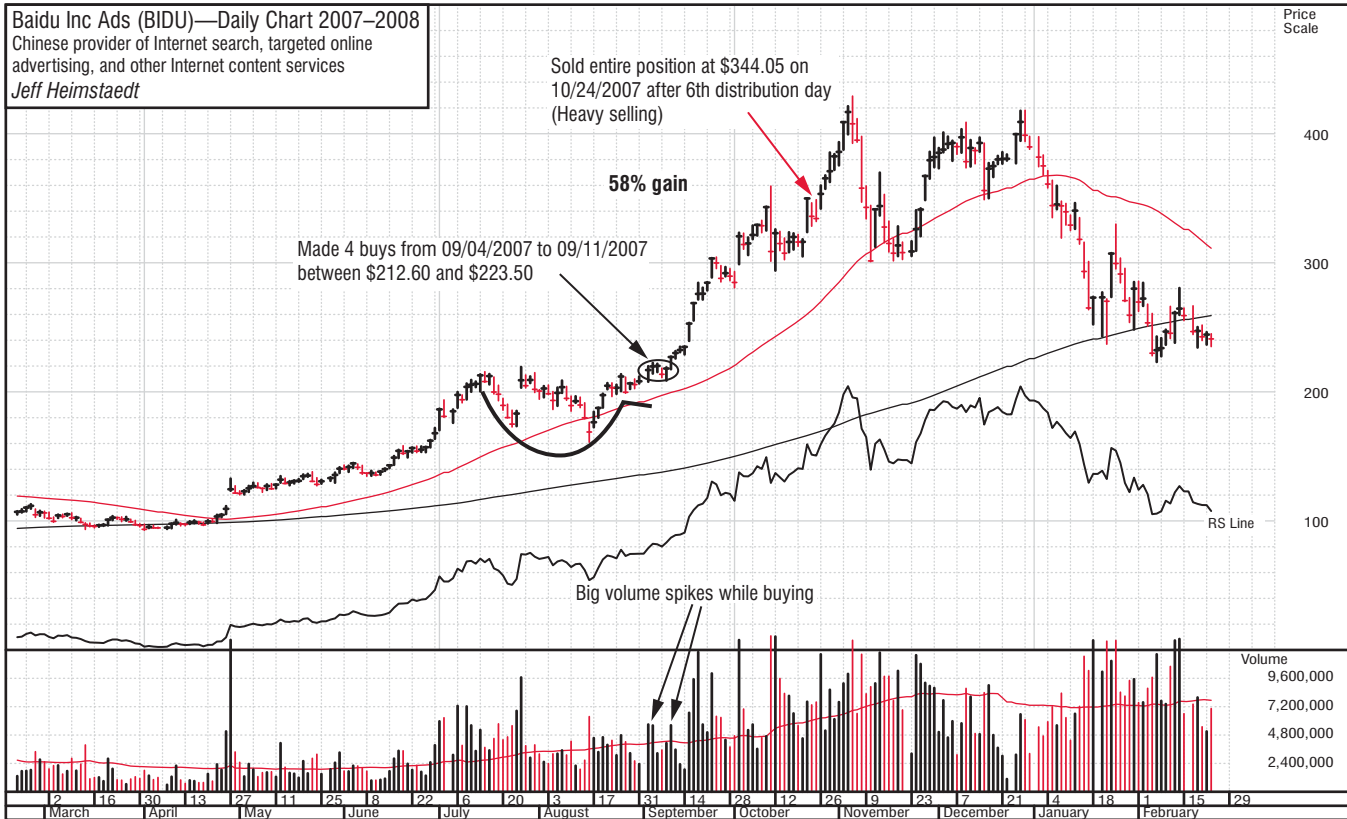
• KEY POINTS •

- The *Big Picture* column is a great way of understanding the market's current trend.
- Use *Stocks on the Move* at Investors.com and in IBD to find stocks that are rising or falling on unusual volume for various options strategies.

Crocs Inc (CROX)—Daily Chart 2006–2007
 Manufactures men's, women's, and children's footwear made with proprietary resin material called croslite
Jeff Heimstaedt

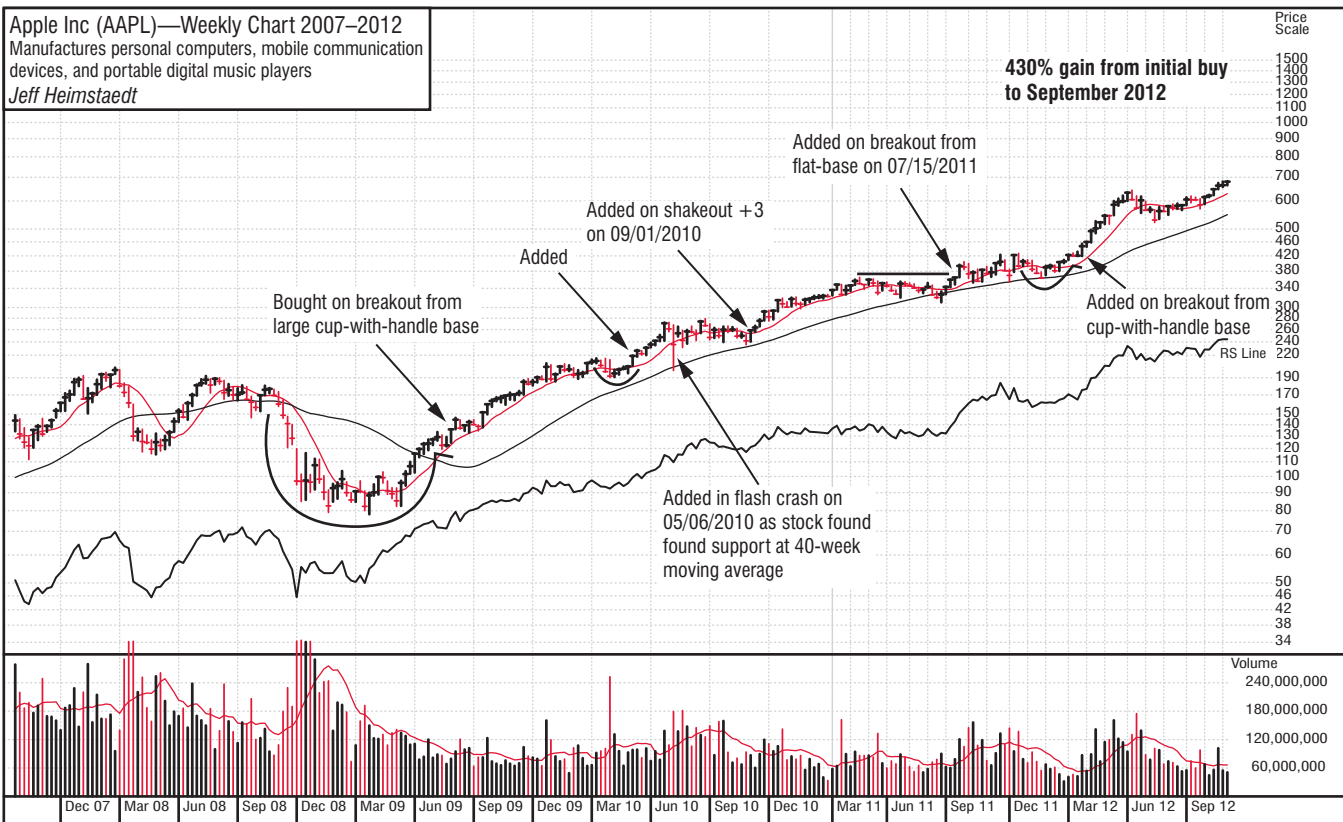


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Apple Inc (AAPL)—Weekly Chart 2007–2012
Manufactures personal computers, mobile communication devices, and portable digital music players
Jeff Heimstaedt



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Black Belt Testing: Life-Changing Moments in Investing

“No matter how tall the mountain, it cannot block the sun.”

— CHINESE PROVERB

There is an ancient fable about a Zen master who was out for a walk with one of his students and pointed out a fox chasing a rabbit. The master said, “The rabbit will get away from the fox.” “Not so,” replied the student. The master insisted, “The fox is faster, but the rabbit will elude him.” When the student asked why, the master replied, “Because the fox is running for his dinner, while the rabbit is running for his life.”

Barbara James

Barbara had been following IBD and investing for several years when she suddenly lost her husband of 30 years to a heart attack. A year and a half later, she was laid off from a major corporation where she was an execu-

tive secretary. Barbara was nearing retirement and thought it was unlikely that she would be hired at the income level she had been receiving. She also knew Social Security would never take care of her financial needs.

An Uptrending Market and Focusing on the Rules Pays Off

Knowing she would be laid off from her job in 2004, Barbara paid off her house and car loans using the extraordinary profits she had made from trades during the booming 1990s: 1,300% in EMC, 200% in Gap, 254% in Oracle, 235% in Intel, and 44% in Cisco.

Though she went through a very difficult emotional period after losing her husband and being laid off from her job so soon afterward, Barbara has advice for investors facing similar challenges. “Have self-confidence in your own abilities,” she says, “but you must study, and you must learn to read charts. Chart reading is a visual art. What do you see? What is the chart telling you? Then act accordingly. You also have to let the overall market trend be your guide as to whether it is a good time to be in stocks or not.” Barbara modestly adds that she had no financial background whatsoever. “I sold real estate and was a secretary, so if I can become a successful investor, anyone can.”

Barbara says she learned the most from the IBD workshops, which she has attended regularly throughout the years, and always walks away having learned something new: “It is the continual process of learning that is so beneficial. And the paper is also full, every day, with educational materials to help people become better investors and better chart readers.”

A Good Routine Can Be Profitable

Barbara follows a solid routine every morning, and this assures her that she won't miss a market leader as it's breaking out.

1. In the pre-market, Barbara checks *The Big Picture* column and the *Market Pulse* to see if the market is in an uptrend or a downtrend. Barbara circles leaders that are up in volume from this section and adds them to her watch list.
2. Next, she runs two MarketSmith screens.
 - a. The first screen that Barbara runs is the William J. O'Neil screen, which brings up stocks with the CAN SLIM criteria. Barbara clicks

through the charts that appear on this list to see which ones may be setting up and nearing a potential buy point.

- b.** Then she runs a screen for stocks up on big volume because this tracks what the institutional investors are buying.
- 3.** Barbara then reviews Leaderboard and finds the list saves her time because “it’s a very focused list of the market’s current leaders.”
- 4.** Finally, Barbara looks at *Stocks on the Move* at Investors.com, another screen that highlights stocks that are rising or falling in heavy volume, showing where institutional money is flowing.

What Barbara is looking for are stocks that show up on several of these different lists. That might be an indication that she has found a stock that could make a big move.

Barbara says, “The key is creating a routine that works for you, something you will continue to do on a consistent basis, every day.” Part of her routine also includes a morning phone call with a trading buddy. They talk about the general market together and look through charts in search of breakouts.

Barbara does best in the market when closely following the CAN SLIM rules and takes most profits at 20 to 25% and cuts every loss at 7 to 8% from her buy point. In a more volatile market, she will cut losses at 5 to 6%.

In 2009, Barbara had profits of:

Fuqi International (FUQI). 42%

Green Mountain Coffee Roasters (GMCR). 21%

F5 Networks (FFIV). 15%

Silver Wheaton Corp. (SLW). 39%

SPDR Gold Shares (GLD). 17%

and, in 2010, profits of:

NetApp (NTAP). 21%

SanDisk Corp. (SNDK). 27%

In Earnings Season, Always Know Your Stock’s Release Date

That same year, Barbara admits to having a “favorite pet stock” with F5 Networks (FFIV) and bought the stock three times. In April, she sold for a profit of 12% and in November for a profit of 22%.

But the third time for F5 Networks was not the charm. Barbara broke one of her rules and bought the stock right before earnings. F5's earnings disappointed expectations, and the stock dropped 26%. She said it was a stinging reminder to never buy stocks right before earnings because anything can happen. A stock can soar on good earnings or dive precipitously on disappointments. Barbara had let a nice gain in F5 Networks evaporate. She states that because she had done well with the stock previously, it caused her to not be as diligent as she usually is in writing down earnings dates for stocks that she owns.

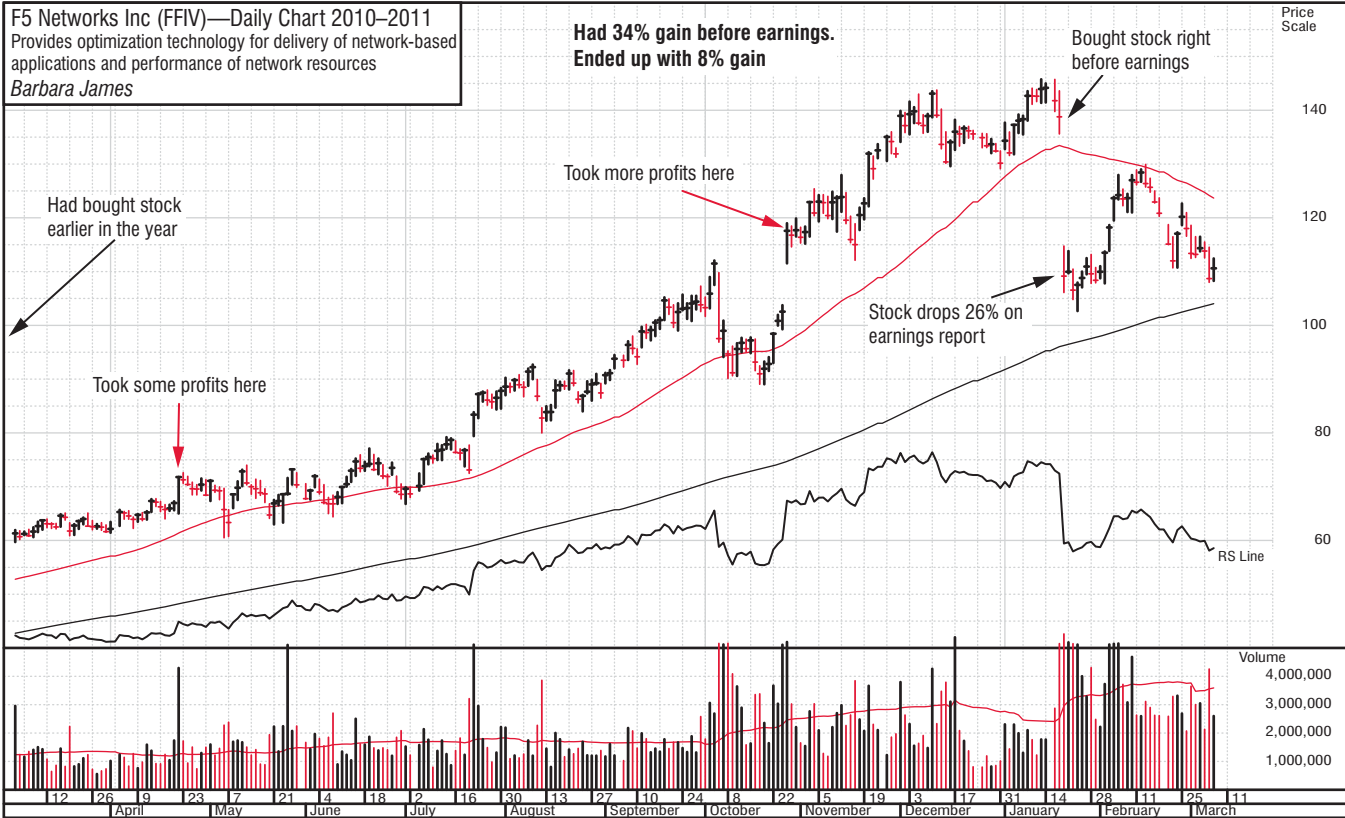
One of Barbara's greatest joys is in helping newer investors. She works part time for IBD at the many Money Shows that are held throughout the year. Barbara sits down one-on-one with attendees and goes over her routine to find winning stocks as well as showing people how to use the paper more effectively. Barbara feels she is helping women and retired investors who are worried about their financial situation as they grow older. Sadly, she has heard many heartbreaking stories from people who did not have a sell rule and suffered devastating losses of 40 to 50% in their retirement savings.

Barbara relates her own story and how she overcame financial challenges and encourages them to learn the CAN SLIM strategy to help them change their lives for the better.

Barbara says, "I manage my own stock portfolio accounts, both my main trading and IRA accounts. There was a pretty big learning curve involved that went beyond studying and learning to read charts. The biggest obstacle I had to overcome was developing self-confidence in my abilities. My success in these accounts has without question proven that I am capable of managing my own money better than any stock broker or financial money manager that I had tried. This was a major breakthrough in my thinking process. Any time I handed my account over to a money manager, they did not do nearly as well as I did. I can now say no one will manage my money better than I will."

Her stock market profits pay for annual month-long trips to exotic locations around the world. She has traveled to India, Asia, Costa Rica, Africa, Australia, New Zealand, and Eastern Europe, among other places.

F5 Networks Inc (FFIV)—Daily Chart 2010–2011
 Provides optimization technology for delivery of network-based applications and performance of network resources
Barbara James



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• KEY POINTS •

- Learn to read charts.
- Let the overall market trend be your guide, whether it's a good time to be in stocks or not.
- Follow a daily routine to stay in sync with the market and leading stocks.
- Take most profits at 20 to 25%.
- Cut every loss 7 to 8% from the price paid for the stock.
- Never buy stocks right before earnings.

Jerry Samet

Jerry had been a professional investor in the stock market for several years before coming across the CAN SLIM Investing System. After the crash of 1987, which left many investors stunned, a friend handed Jerry a copy of *Investor's Business Daily*. After seeing the quality of the paper and the information that was in it, Jerry bought *How to Make Money in Stocks* and devoured the book. Suddenly, a lot of things made sense about the market that he had never realized before, even as a professional trader.

By the time the bull market of 1991 started, Jerry formed an investment firm with a partner and began to experience tremendous gains using the system.

A Stock That Triples in Price Can Still Go Up

Jerry had his first eye-opening experience with growth stock investing when he bought ECI Telecommunications. The stock had already tripled in price before he bought it in August 1991. Jerry sold ECI in March 1992 for a gain of nearly 200%. Before he learned CAN SLIM Investing, Jerry “thought anyone would be crazy to buy a stock that had already tripled in price *before* they bought it.”

The Unexpected

In 1992, Jerry found himself in a very difficult and stressful situation. His partner had died of a heart attack, leaving him the burden of managing \$10 million by himself. Jerry says he was never really the corporate type. Addressing

questions or concerns from clients at all hours of the day was something he found increasingly difficult because it disrupted the trading day. Besides, it was psychologically draining. Some of his clients wanted to be in the market all the time, even if the environment wasn't right. By 1994, Jerry made the decision to stop managing money professionally and returned all of the money to his investors. But by this point, he also had enough confidence in the system from several successful trades to begin investing his own money full time.

Lessons from the Trenches

In October 1999, Jerry bought Qlogic (QLGC) and made 150%. He could have increased his profit even more but sold too late after the stock topped. At that time, Jerry wasn't as experienced about how to handle a climax top. This is when a stock has a rapid price run up for one to two weeks after an advance of many months and then rolls over. This climactic activity usually occurs in the final stages of a stock's advance.

The reason Jerry was able to buy Qlogic is because of his experience with ECI Telecommunications. He bought Qlogic after it had already tripled in price, which is almost exactly what ECI had done. This taught him a very valuable lesson: winning stocks repeat themselves with similar patterns and behaviors.

Jerry learned another valuable lesson with EMC in 1999. He bought the stock at \$68 but got shaken out and took a loss. He sold at \$61. But the stock went on to build a cup-with-handle base. Jerry learned to keep watching stocks that didn't work the first time he tried to buy them, because big winners often give you another chance.

In November, he bought EMC again as it came out of a base at \$75 and sold it at \$112 in 2000 for a 49% gain.

Then, in 2003, Jerry bought J2 Global Communications (JCOM) in March and sold it in October after a two-for-one split for a 198% gain.

He learned that it was important to bag gains early in a bull market cycle. That's when market leaders really pop and the big money will be made.

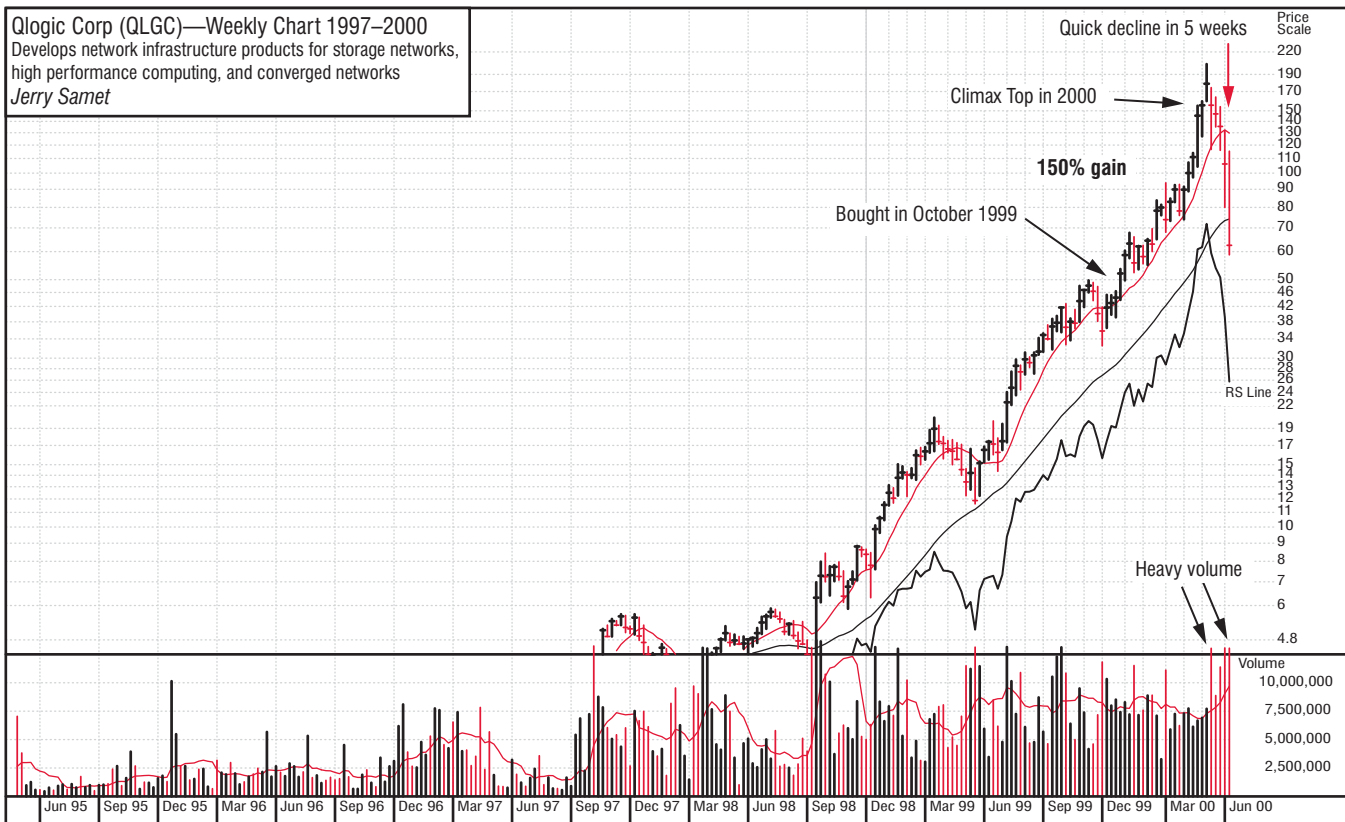
Recovering from a Setback

Then a hard blow came for Jerry due to several factors, including what he feels was overconfidence in his trading abilities. He lost half his money in a drawdown. For a serious trader, losing a large amount of money can be the darkest moment, filled with self-doubt and disillusionment.

Qlogic Corp (QLGC)—Weekly Chart 1997–2000

Develops network infrastructure products for storage networks, high performance computing, and converged networks

Jerry Samet



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Over the years, Jerry had attended IBD workshops multiple times, so he went back and studied the workshop books. The first egregious error was in not cutting losses sooner. As Jerry examined his trading mistakes, he learned that the emotions of euphoria when he was doing well in the market as well as being too distraught when a trade went against him were damaging to his trading. He studied and worked hard with a trading coach that specialized in psychological barriers and learned to keep a more even keel and be calmer in his everyday approach to the market.

He found out that the most dangerous time is when you're doing really well in the market, because you get sloppy: "The market will prove to you that you're getting cocky."

Jerry has been very successful in the market since adjusting his trading. He mentions with a chuckle, "If things are going well and I'm really excited, it's a good indication the market may be topping."

Now when he is doing well, Jerry calmly takes some gains off the table and takes his family on a vacation. He found that it is important to reward yourself at least in some small way when you've had some success. This keeps overconfidence in control.

One of the biggest lessons Jerry has learned is that you can make a lot of money in a rally only to give it back in a correction. This can be extremely frustrating. "One of the hardest things is to stay out of a correcting market," he says. "Although you can get some of the biggest up days in a bear market, and this makes it tempting to go back in, you buy some stocks and take small losses, then buy a few more stocks, and then take a few more losses. Pretty soon, if you do that enough times, even if you are cutting your losses, you'll often lose a decent amount of money."

To keep from giving back gains that he made during an uptrend, Jerry refuses to buy stocks if there are only three or four stocks that are making decent gains in the market. He is looking for true confirmation in the market, and that means that 10 to 15 or more stocks must be setting up and looking good. "If the market doesn't look strong, you have no business getting in."

The Leaders Index

To help him determine if the market was in a good phase or a so-so phase, Jerry set up what he calls his "leaders index," which is a mixture of 20 to 25 stocks from 15 different industry groups. Jerry does this early in every new uptrend. He creates the list by searching for stocks that look strong as a new uptrend is beginning.

Many of these are stocks that have already broken out. Stocks that are a bit extended are great candidates, because Jerry knows from market history that these are the stocks that are most likely to go higher. Stocks making new highs tend to go higher.

Jerry looks for stocks with strong fundamentals, big earnings and sales, and a great new product or service that is in demand.

He follows this “leaders index” as a gauge of the general market and updates its performance on a daily basis. Jerry e-mails the daily results of the index to several IBD Meetup Groups. He says that sharing the results helps him stay “honest about what the market is actually doing.” Jerry also helps teach at several IBD Meetup Groups and always enjoys the exchange of ideas.

He says, “I can wear Hawaiian shirts and shorts to work, come and go as I please, take a vacation when I want, have the luxury of spending more time with my family, and I don’t have a boss telling me what to do. It suits my personality well.”

• KEY POINTS •

- Winning stocks repeat themselves with similar patterns and behaviors.
- Keep watching stocks that don’t work out the first time they are bought. They may offer another opportunity.
- It’s important to get in early in a new bull market cycle. That’s when market leaders really take off.
- If you’re doing very well in the market, be sure to keep emotions under control.
- Reward yourself in some small way if you’ve had success.
- Stay out of a trendless market; small losses add up.

Mike Hicks

Mike first became interested in stocks through business courses taken in college. His first job was at a CPA firm that had a library and a couple of books on equities. After reading a few books, he decided to dabble in the market.

The Early Years

Mike thought cheap stocks looked interesting, so he bought Ramada Inn when it was under \$5. He made a 13% gain, which seemed pretty good for his first stock pick. But he quickly learned that duplicating that success was going to be difficult.

Through the years, he was confused by all the information that was out there and didn't understand which methodology he should be following.

Mike had continually tried to be a bottom fisher because he never had the confidence to buy a stock that was so far up from what he thought was a low-risk entry price. As a result of continually buying cheap, low-quality stocks that weren't showing earnings growth, he frequently lost huge percentages on his individual stocks as well as having a meager overall portfolio performance.

In 1989, an architect friend introduced him to IBD. Mike stared for a few moments at the paper and all of its detailed information. "I was so absolutely amazed that I almost had to sit in a chair," he says. "This is what I had been looking for all my life." He made a plan in the back of his head that investing would be his retirement career.

Mike continued to be a subscriber to IBD, but time was in short supply because he was busy with his own CPA firm. So although Mike bought stocks here and there, he didn't get serious about investing until 2002.

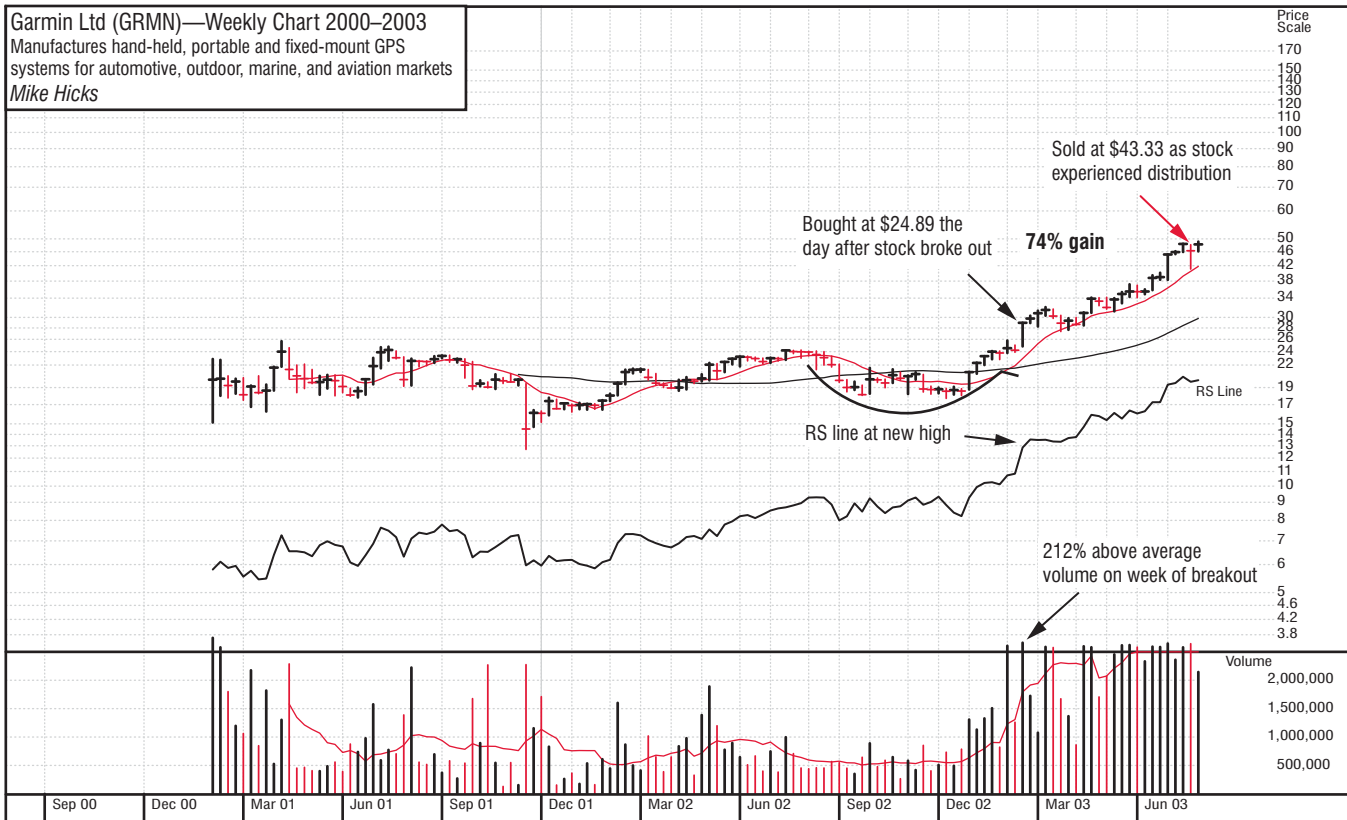
Mike began focusing on stocks that showed a rare combination of traits: strong volume demand and stellar fundamentals. These are the market leaders that exhibit earnings and sales that are far outperforming the market averages, which is why they kept showing up in various features in IBD week after week during their massive runs.

The Breakthrough

Garmin (GRMN) was one of the first successful stocks Mike bought in December 2002, using the CAN SLIM Investing System. He bought the stock as it was coming out of a cup-with-handle base and logged a 74% gain.

After a particularly grueling tax season in 2003 and buoyed by his success with Garmin, Mike decided to really study the CAN SLIM System intensely. He sat in his office for an entire weekend and printed out a huge amount of educational pieces from Investors.com. As he read through the material, he had an epiphany. Mike was beginning to put all the pieces together: he needed to focus on stocks that had great fundamentals com-

Garmin Ltd (GRMN)—Weekly Chart 2000–2003
Manufactures hand-held, portable and fixed-mount GPS systems for automotive, outdoor, marine, and aviation markets
Mike Hicks



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bined with the right chart action. These were stocks that had at least double-digit earnings numbers and were breaking out of areas of price consolidation on big volume.

Mike also began to read all of the books Bill O'Neil had on his recommended reading list: *How I Made \$2 Million in the Market* by Nicolas Darvas, *The Battle for Investment Survival* by Gerald Loeb, *My Own Story* by Bernard Baruch, and *Reminiscences of a Stock Operator* by Edwin Lefevre.

The Life Changer

In May 2003, Mike was reading an IBD *New America* article and learned about a stun gun called Taser. He realized that this could be a big winner because of the development of a nonlethal weapon that would improve a police officer's options to capture and detain suspects. He bought Taser (TASR) in September 2003 and sold it in October for a 105% gain in 30 days. This was a very exciting moment for Mike; he had done well with Garmin and now had a triple digit gain with Taser. His confidence was soaring.

But Mike was frustrated as Taser continued to rocket higher—another couple hundred percentage points—and he realized he had sold too early, though IBD analysis hadn't indicated this. His heart sank, but, realizing his mistake, he started looking for a proper new entry point. In December 2009, the stock formed a series of rare high tight flags. This is when a stock has a fast advance of 100 to 200% in 4 to 8 weeks. Then a stock moves sideways for 3 to 5 weeks before making another run. High tight flags are very rare and only seen in the market's biggest winners. After this formation, stocks usually make a massive move upward.

Mike bought the stock back again. His position was significant as he pyramided into the stock and added to his position. Then Mike did something that is hard to do: he sat tight with a volatile stock. When a stock gyrates and is a bit of a wild thing in daily price swings, it can be difficult to sit with. This will test your nerves, but it's where a set of rules comes into play. You sit with a stock that has proven itself to be a true market leader. Taser never went below its buy point, so Mike held onto it, despite some wild price fluctuations.

Then he saw some climax activity in the chart. The stock had gone up a tremendous amount, and Mike realized that this might be a dangerous time. He knew from his studies that all stocks top out at some point. On April 19, Taser was due to report earnings after the close. Lawsuits and bad news were beginning to creep up, and there were other yellow flags, such as

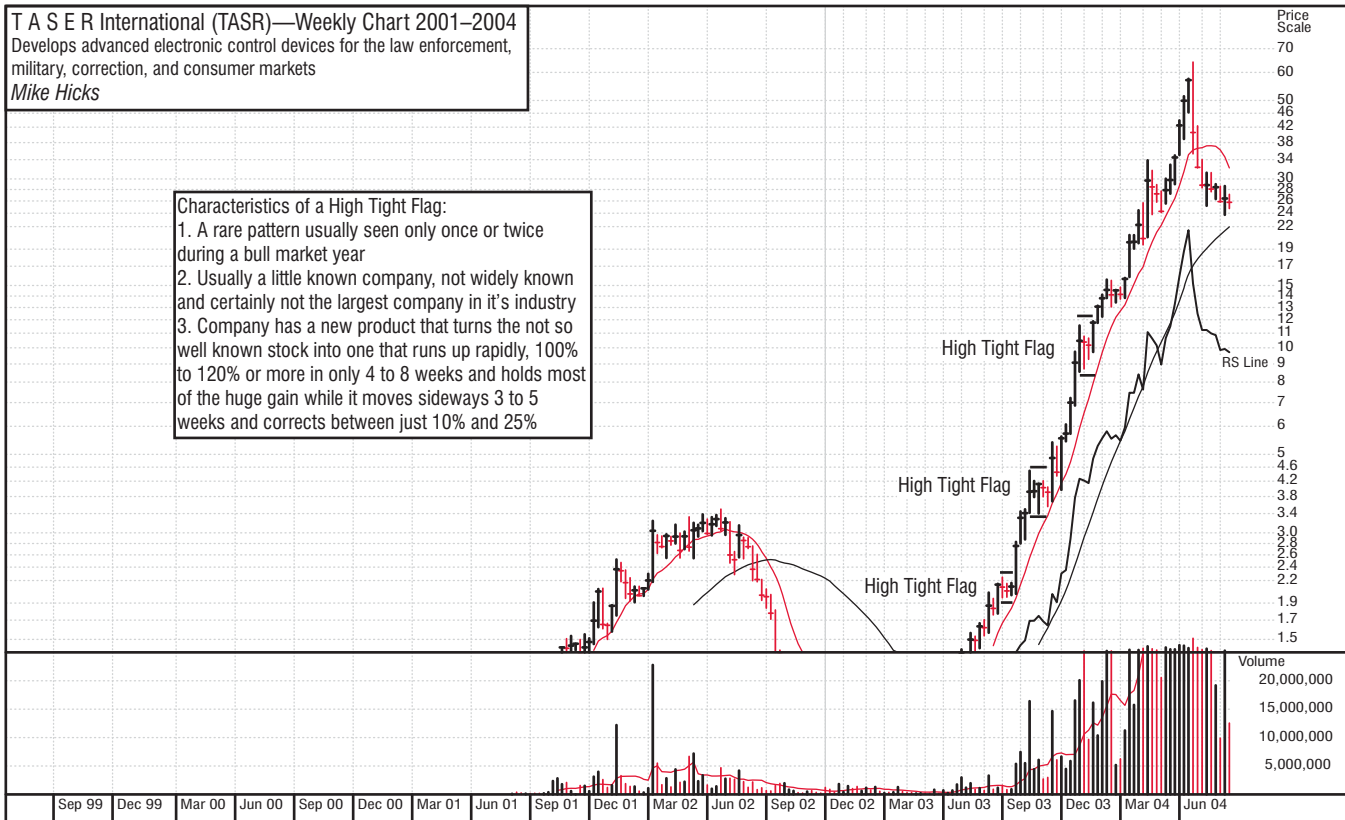
T A S E R International (TASR)—Weekly Chart 2001–2004

Develops advanced electronic control devices for the law enforcement, military, correction, and consumer markets

Mike Hicks

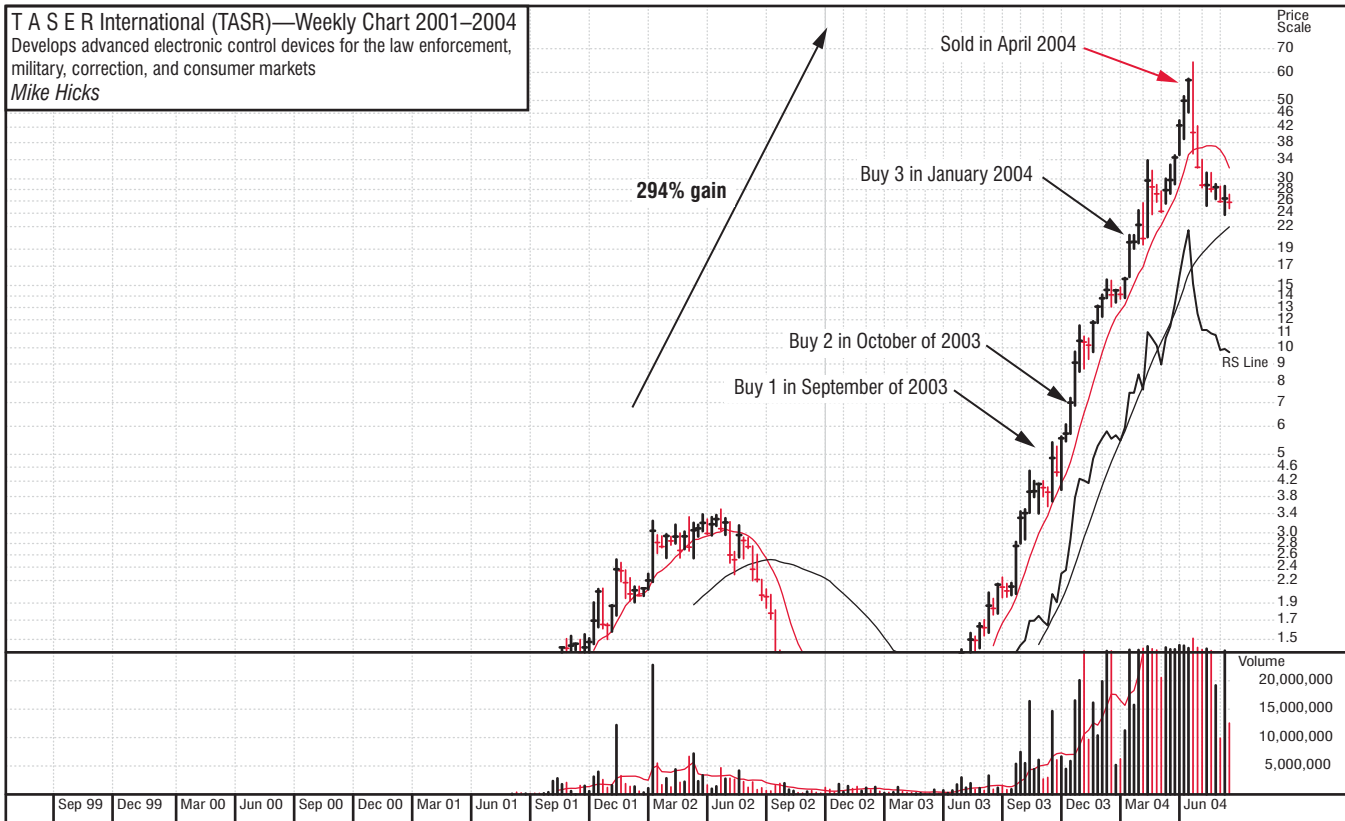
Characteristics of a High Tight Flag:

1. A rare pattern usually seen only once or twice during a bull market year
2. Usually a little known company, not widely known and certainly not the largest company in it's industry
3. Company has a new product that turns the not so well known stock into one that runs up rapidly, 100% to 120% or more in only 4 to 8 weeks and holds most of the huge gain while it moves sideways 3 to 5 weeks and corrects between just 10% and 25%



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T A S E R International (TASR)—Weekly Chart 2001–2004
 Develops advanced electronic control devices for the law enforcement, military, correction, and consumer markets
Mike Hicks



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excessive stock splits. Mike made note of this and called his broker that afternoon. He took his entire gains off the table. After Taser released earnings and disappointed analysts' expectations, the stock cratered 29%.

Mike had sold exactly at the right time and had bagged a 294% gain in a stock on top of earlier gains of 105%. This was a very emotional moment for Mike. He closed the door to his office and sat in his chair as tears welled up in his eyes. It was a life-changing moment. Mike had made a six-figure profit in a stock, and he could now pursue his retirement dream of selling his CPA firm and turning to investing full time.

Having a huge gain was both a blessing and a curse, however. After the success Mike found with Taser, he felt every stock would be a huge winner and, as a result, has had a tendency to be a home run hitter since then. The problem he found is that not all market environments produce giant gains like Taser.

Mike has since learned to take profits at 20 to 25% instead of giving back hard-earned profits.

One thing that helps him stay in step regularly with the market and reduce his mistakes is teaching. In October 2003, after Mike's first big gain in Taser (TASR) of 105%, he formed an IBD Meetup Group in his hometown of Clearwater, Florida. He said this was one of the best decisions he has made in his stock market career. He has found other people who are passionate about the market and who invest the same way. Mike has also enjoyed helping a number of newer investors get started and enjoys watching their success.

• KEY POINTS •

- Focus on stocks with strong fundamentals breaking out of areas of consolidation on big volume.
- Sit patiently with a stock that is a true market leader.
- Don't try to be a home run hitter all the time. Not all market environments produce gains like Taser's.
- Read *The New America* article.
- Look for unique products that are in big demand.

Ed Hornstein

Ed was raised in a middle class family in the suburbs of Long Island, New York. Throughout his childhood, his exposure to the stock market consisted of watching his father buy stocks on “hot tips.” Every stock that his dad bought was supposedly going to be a ten bagger and make him a multimillionaire. However, the reality was that his father would lose a small fortune in the stock market by listening to whatever stocks were being pumped by his broker. Ed’s experience of watching this completely turned him off to the markets.

Ed borrowed \$100,000 in loans to pay for law school and quickly came to the realization that in order to pay off the loans, he would need to land a job with a firm that could afford to pay a six-figure salary to starting associates.

As he entered law school, it became quickly apparent that he was surrounded by extremely talented and intelligent people. Ed figured that several had IQs that dwarfed his and that if he was going to obtain the grades necessary to land a job with one of those large firms, he’d have to outwork them. He spent the first year of law school either in the classroom or pulling all nighters in the library. That work ethic paid off: Ed finished his first year near the top of his class and was recruited to work for a highly ranked law firm in its New York office for the summer.

Ed never paid much attention to the stock market during law school and completely missed the tech bubble and explosion in Internet stocks in 2000. But after he graduated and began working, Ed decided it might be prudent to invest some of the money he was making. He knew that he needed to learn a thing or two about stocks before committing capital, so he read a few books about value investing and other stock market strategies. None of it made much sense to him, especially after seeing people buy cheap stocks only to lose most of their money.

A few months later, Ed was in a bookstore and noticed a copy of *How to Make Money in Stocks* sitting on a table. He picked up the book, browsed through it, and decided to purchase it. Little did he know at the time that this decision would forever change his life.

The key principles all made sense. Shortly thereafter, he purchased *The Successful Investor*, which really resonated with him. He realized that his friends and family could have kept the small fortunes they made in the late 1990s if they had followed some simple sell rules.

Throughout the rest of 2002 and 2003, Ed read Bill O’Neil’s books multiple times: *How to Make Money in Stocks*, *The Successful Investor*, and *24 Essential Lessons for Investment Success*. These books were intended to make the rules and guidelines register with investors in a deeper way.

Testing His Wings

In March 2003, a new bull market began, and Ed started trading stocks. He quickly turned \$50,000 into nearly \$300,000 until the market corrected in early 2004. Reading and understanding CAN SLIM Investing, however, was entirely different than its application. By the end of the correction, because he didn’t stay out of the market while it was heading lower, Ed lost every penny that he’d made. When he did his post analysis, he realized that he did not follow the CAN SLIM sell rules he had studied.

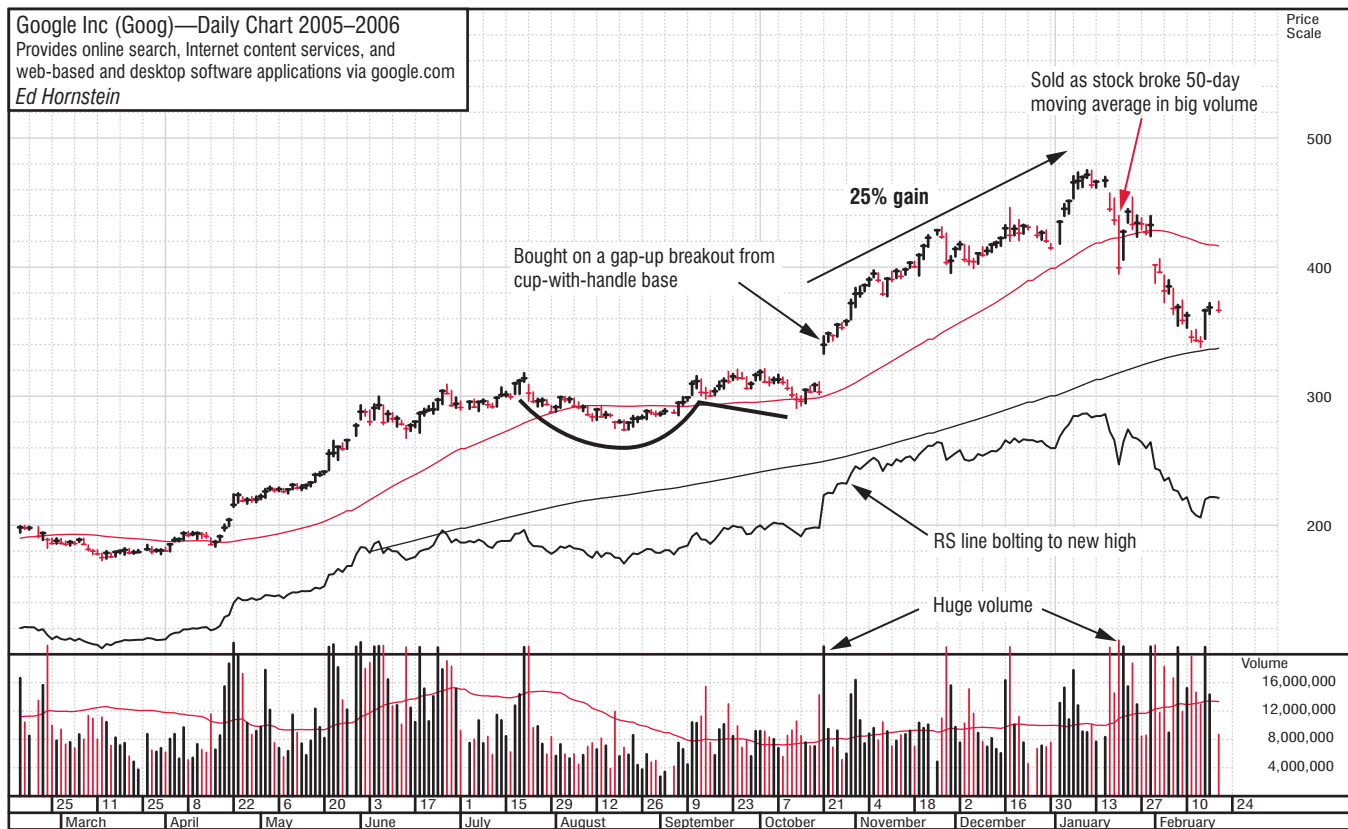
Ed spent the next three years of his life immersed in mastering CAN SLIM and learning every detail he could about the system and how to use it effectively. Besides studying, Ed also traded his own account and made “almost every mistake that a trader can possibly make. The market can evoke emotions in everyone, causing one to break rules, overreact, and make mistakes.” Because Ed had no mentors, he had to learn everything by trial and error and experience. Instead of becoming disenchanted when he would lose money on a stock, however, he would mark up a chart to see the reason for his mistake. And he constantly reviewed them so he wouldn’t make the same mistakes again.

Hitting His Stride

At the end of 2005, Ed had his first “big stock experience.” Ed missed out on Google’s first two base breakouts, but when the stock gapped out of a base on October 21, 2005, he bought what was a rather large position for him at the time. He had studied models of past breakaway gaps of former leaders, and he knew this was a high probability play, despite many pundits saying the stock was overvalued. He spotted volume accumulation on a weekly chart and saw the continued demand as it ran up. On January 20, 2006, Ed locked in a large profit by implementing one of his sell rules, which is to sell a stock if it breaks its 50-day moving average on heavy volume.

Ed noted, “Holding onto a big winner is sometimes hard, and that’s why you have to know everything about a stock and a company, because if you don’t know much about the product, its useful place in the market, why sales

Google Inc (Goog)—Daily Chart 2005–2006
 Provides online search, Internet content services, and
 web-based and desktop software applications via google.com
 Ed Hornstein



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may increase, or why its product or services may be in demand, the more likely you are to get shaken out of it. Conviction is definitely key to holding onto a big winner. You have to ask yourself, ‘Why is this company likely to be successful in the future? Does it have a remarkable product or service that is revolutionary in its industry?’”

Another important factor that Ed looks for is liquidity. He wants a stock that big funds would buy, and more thinly traded stocks don’t capture the attention of the big institutional investor.

By 2006, Ed had made enough money with CAN SLIM Investing that he decided to follow his new passion, the stock market. He had always dreamed of owning his own business and was further motivated by reading about all the successful entrepreneurs in the *Leaders and Success* column in IBD.

Freedom to Follow His Passion

Although he had virtually no clients and no experience managing professional money, he felt that if he followed his passion, continued to work hard, and stayed true to the principles of CAN SLIM Investing, he could make it a full-time career.

At the end of 2007, Ed said good-bye to the law firm where he had begun his career and launched his own money management firm. He slowly built his client base, and when the market crashed in 2008, he had his clients’ money safely in cash. Although he didn’t know how severe the crash would be, he recognized the breakdown of leading stocks and the large amount of selling in the financial stocks. That made him realize cash was the safest place to be.

A new bull market began in March 2009, and during that year, Ed’s firm did so well that he decided to launch a hedge fund in January 2010. The fund did well in 2010, but in 2011, Ed faced a more difficult period. For the first time since he started managing money, he wasn’t performing up to peak. After he went back and analyzed the entire year, he realized that portfolio concentration was the problem, and he needed a new set of management rules for choppy, difficult markets.

He made a “threshold rule”: if the market issued a follow-through day, he would go in no more than 20% invested, unless the stocks in his portfolio made a gain of 2%, then he could go in a little deeper. Even if he was tempted to buy more than he should, having portfolio management rules would keep him out of a choppy market.

Even though 2012 was an easier environment to trade in, having the 20% threshold rule helped Ed outperform the S&P by nearly double through September 2012. Ed seeks to “constantly learn through post analysis and make new rules that will help him as a trader.”

Ed also noted that no matter how good you get at investing, you’re going to have a bad year at some point, so it’s important to fix mistakes. He said that he learned a lot more in the difficult 2011 period than in easier up years. “Don’t be afraid of your mistakes, but make rules to fix them.”

He continues to be a student of the market, studying and learning. Ed also likes to go to a local mall and see what people are buying. He was able to make a nice profit from Chipotle Mexican Grill when he noticed one open near his old law firm and saw lines 45 minutes long for healthy fast food.

Ed says that had he not read *How to Make Money in Stocks* nine years ago, he might still be a lawyer, working long hours and being unhappy with his profession. Instead, now, not only does he have his own hedge fund where others trust him to manage their money, but when he wakes up in the morning to go to work, he is excited and passionate about every waking hour he spends analyzing the market and trading. “My life is much more fulfilling than I could imagine as I have much more free time to spend with my family and three-year-old son. Mr. O’Neil, I thank you for making this all possible.”

Google. 25% gain 2005

Vmware. 80% gain 2007

Dryships. 91% gain 2007

Michael Kors. 80% gain 2012

LinkedIn. 100% gain 2012

Priceline. 50% gain 2012

Apple. 28% gain 2012

• KEY POINTS •

- Sell a stock if it falls below the 50-day moving average on heavy volume.
- Ask why a company you are considering buying is likely to be successful in the future. Does it have a remarkable product or service that is revolutionary in its industry?
- Gap-ups can be bought on a stock that has established itself as a market leader and has top fundamentals. The gap-up should be on heavy volume.
- Be a continual student of the market.

Becoming a Master: Continually Studying the Market

“Study the past if you would define the future.”

—CONFUCIUS

In martial arts, becoming a master isn’t a destination, but more of a journey. It is a continual quest for knowledge and improvement through practicing and trying to improve on weaknesses.

The most successful investors are constantly studying and looking for ways to improve their prior performance. Examining past trades and former stock market winners can often give clues about how to find successful trades in the future.

Daily Journal and Post Analysis

Katrina Guensch is a mediation lawyer who lives in Florida. As part of her ongoing quest to become a better trader, she keeps a daily journal so that she can go back and understand what she was thinking at the time about the

market and leading stocks. If she has a busy work week, Katrina will catch up and make sure that at the very least, she writes in her journal on a weekly basis. By putting her thoughts down on a regular basis, she can go back and see what her perspective was at the time about stocks that she owned as well as the general market.

Katrina also does an extensive post analysis of her trades. She prints out daily and weekly charts when she buys or sells a stock. This provides her with a chart diary that includes her reasons for buying or selling a stock and what the fundamentals were at the time, such as earnings, sales, and return on equity.

Post Analysis Guidelines

The primary purpose of any post analysis is to formulate specific rules that address your unique weaknesses.

Your post analysis should lead you to a better understanding of the nature and essence of your trading successes and failures.

- 1.** Throughout the year, print daily and weekly charts upon buying or selling a stock.
- 2.** Once a year, organize the charts for the previous 12 months based on performance.
- 3.** Analyze your largest percent gainers and largest percent losers.
- 4.** As you study your individual trades, ask yourself these questions:
 - Did I break any rules?
 - Did I enter the position correctly?
 - What percentage of the portfolio ended up in leading groups and stocks?
 - Did I buy at the right time?
 - Did my emotions cause me to sell?
 - Did I miss big opportunities by selling too early?
 - Was I heavily on margin? Did I handle the additional risk correctly?
 - Did I miss obvious clues to sell or fail to sell at the right time?
 - Did I evaluate my individual stock and portfolio risk for each decision?
 - What happened to my stocks after I sold them?

Don't complicate the process by having too many rules. Focus on your top one or two weaknesses. Remember, the point of your analysis is to formulate your rules. Use your analysis to establish rules for yourself. Write your rules down to reinforce them.

Back Testing

Lee Tanner does market simulations to compare how well he actually did in a particular time period with what he might have been able to achieve. He learned this technique from an IBD Level 4 workshop in 2004. He says, "The great thing about back testing is there are no emotions involved, but one can practice what they might have done in similar market circumstances."

To do his analysis:

1. Lee goes back in time, using the date change feature in MarketSmith, to a time period shortly before a new market rally started and builds a "theoretical" watch list of stocks as objectively and realistically as possible by using:
 - His old watch list of stocks that were setting up, as well as notes or IBD articles that he saved from that time period
 - *e*IBD features from the time period, especially the *IBD 50*, the *Big Cap 20*, and the 85-85 index
 - Stocks that were on Leaderboard at that time
2. Lee goes through the market and the stocks that are on his theoretical watch list day by day, week by week, looking at charts and trying to find the big winners. He finds this part of the simulation particularly useful because he can see the charts as they looked at the time, not as they look in the present.

Lee makes simulated buy and sell decisions for stocks in the theoretical portfolio the way he normally would in real time while keeping a record of:

- All the watch list stocks for each week of the simulation that were bought and put in the theoretical portfolio
- The market direction for that time and the distribution day count during the simulation

- A trading log with appropriate notes on why he bought each stock
 - The stocks that he decided to trade in the mock portfolio and the gain or loss for each one
3. Then he compares his theoretical portfolio results to his actual portfolio and sees where he can make improvements.

Studying Historical Charts

Tom Ellis has read *How to Make Money in Stocks* five or six times cover to cover. He scanned the 100 charts that appear in the beginning of the book and put together a spreadsheet that contains every cup-with-handle base pattern and the pages where the chart pattern appeared in the book.

He did the same thing for all of the other base patterns so that he could go back and study each pattern in detail.

Tom realized the importance of learning to read charts well from something that Bill O'Neil wrote in a pamphlet titled, *How to Recognize Great Performing Stocks*. Bill said, "You must learn how to read and interpret daily, weekly, and monthly price and volume charts because they can tell you if a stock is behaving properly or not and shows whether the stock is under accumulation (institutional buying). Charts measure the actual supply and demand for a stock and indicate the best time to begin buying as well as the more risky times to continue holding a stock. Reading charts well and recognizing when stocks are coming out of base patterns gives investors an enormous advantage in finding the next big winners when combined with superior fundamentals like strong earnings and sales."

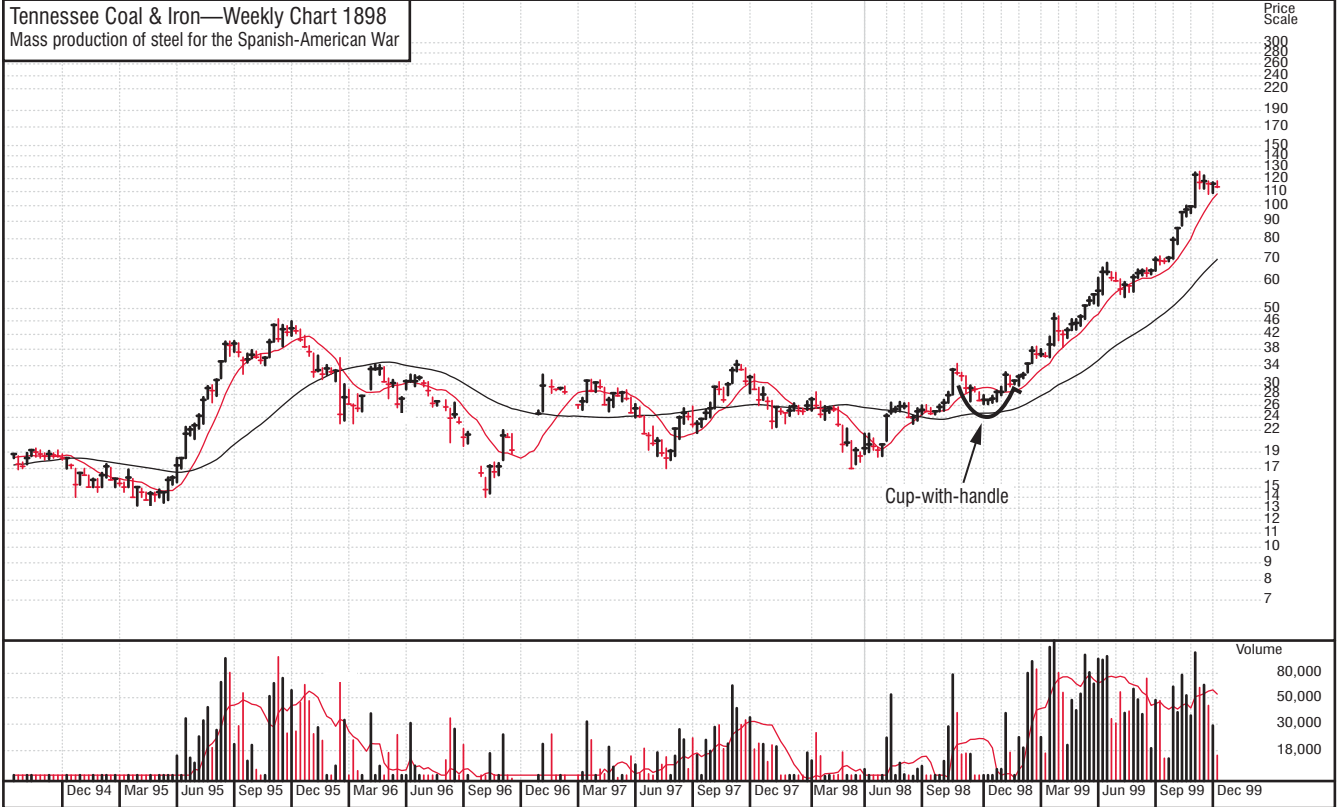
Whether it's Tennessee Coal from 1898 or Apple in 2004, chart patterns of the biggest winners are the same, cycle after cycle.

Tom also saves PDFs of *eIBD* each day so he can go back and study charts of the market's biggest winners. By saving the paper each day, he can also look up what the fundamentals were of a stock at that time.

• KEY POINTS •

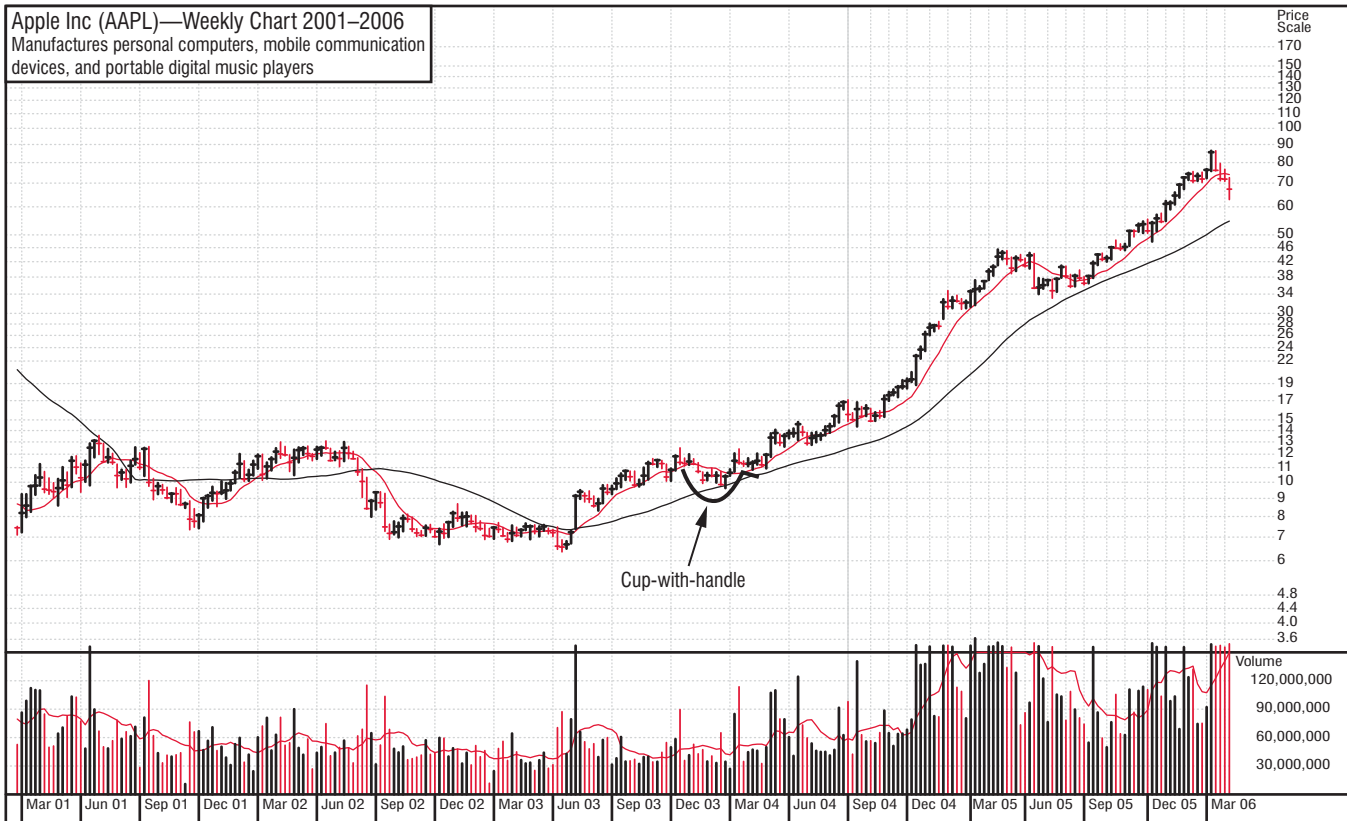
- Keep a daily or weekly journal for stocks that you own as well as thoughts on the general market.
- Do a post analysis of all your trades.
- Back test to see how you might have traded stocks differently.
- Study historical charts of the big winners from the past so you can recognize the same patterns in the present.

Chart Patterns Remain the Same Whether Tennessee Coal from 1898 or Apple in 2004



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Apple Inc (AAPL)—Weekly Chart 2001–2006
Manufactures personal computers, mobile communication devices, and portable digital music players



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10

• CHAPTER •

Black Belt Trading: Investing Like a Pro

“Champions aren’t made in gyms. Champions are made from something they have deep inside them—a desire, a dream, a vision. They have to have the skill, and the will. But the will must be stronger than the skill.”

—MUHAMMAD ALI

It is said that a black belt is a white belt that never quit. Only through perseverance and indomitable spirit can one achieve the highest level in martial arts. It is the same with investing. The top traders develop skills through hard work, discipline, following a daily routine, and controlling emotions. The journey is not always easy, and there will be trials along the way, but anyone can achieve this level if they are willing to put in the work.

Kevin Marder

Kevin started investing in 1985 with a very simple strategy: he bought blue chip stocks from the Dow Jones Industrial Average that had earnings growth of 20% per year.

In July 1987, Kevin noticed that the market was selling off, and so, being a risk-averse investor, he sold many of his positions. But he had no idea what was coming. Kevin turned on the TV on October 19th, the morning of the “Black Monday” crash, and saw that the Dow had dropped 500 points, more than 20%, and that the entire world market was collapsing. He immediately sold his last short-term position, which was Royal Dutch, an oil and gas company. Although Kevin had been more fortunate than many investors, he felt a bit stunned. It was a serious and devastating day for a multitude of traders, and the crash hit many Wall Street firms hard, driving some out of business altogether.

In the aftermath of the crash, Kevin realized he didn’t know how to time the market. His strategy worked in the 1980s because stocks were in a bull market. But now times were different. In 1990, he happened to come across *Investor’s Business Daily* and saw an ad in the paper for *How to Make Money in Stocks*. Kevin bought the book, and as he read through the chapters, he began to see how the markets worked historically. For Kevin, this was a watershed moment. Midway through the book, he felt as though someone had turned a light bulb on in his mind. He put the book down, and he began to pace the living room floor, thinking about what he had just read and what a difference it would make in his trading.

The Learning Curve

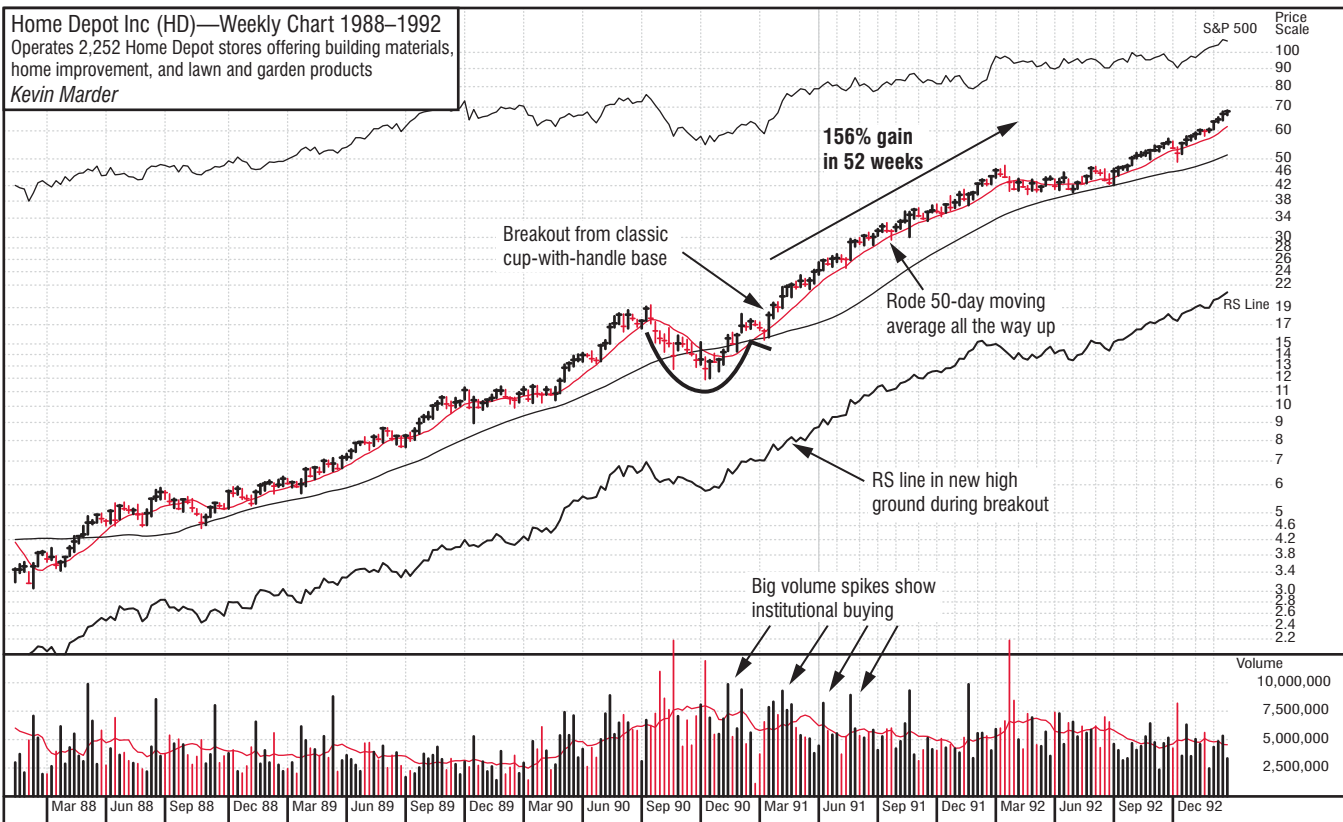
Kevin attended several of IBD’s advanced investment seminars and found that the CAN SLIM strategy fit his personality well, particularly the “N” in CAN SLIM, which stands for something new. He had always been intrigued by new things, whether they were related to cars, fashion, musical styles, companies, or a host of other things. Operating in the aggressive growth sector would allow him to watch firsthand the progress of many companies that were on the cutting edge. These were the names that would crank out the heaviest advances in the stock market because they had customers beating a path to their doorstep.

Kevin began subscribing to the Daily Graphs charting service that IBD offered and would drive down to the printing plant every Saturday morning

Home Depot Inc (HD)—Weekly Chart 1988–1992

Operates 2,252 Home Depot stores offering building materials, home improvement, and lawn and garden products

Kevin Marder



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to pick them up. He says, “All the hardcore stock jocks showed up on Saturday mornings at the plant to get their charts early. You felt like you were part of a secret club.”

One of the biggest technical indicators that Kevin learned to pay attention to on charts was the RS (Relative Strength) line. Kevin learned that what was important was the slope of this line. If the line was upward sloping and hitting new highs, it meant that the stock was outperforming the S&P 500. Conversely, if the line was downward sloping and drifting into newer lows, the stock was underperforming the major indexes. He was looking for the truly big growth stocks that were far outperforming the major indexes, so this indicator was something he would continue to focus on as he looked at charts.

Early in 1991, Kevin recognized that a new bull market had begun. He was able to use the CAN SLIM Investing strategy in “full bloom.” Companies like Microsoft soared as people gobbled up its state-of-the-art software. Home Depot experienced blistering growth by coming out with a chain of innovative home improvement stores offering discount prices. Cisco Systems became an earnings juggernaut by developing technology used to link groups of individual computers together. In each case, these companies had carved out a whole new market.

In the spring of 1993, Kevin would learn a big lesson. He had bought Microsoft out of a base, but the breakout failed, and the stock fell 10%. Kevin didn’t sell. Microsoft dropped some more and was down 15% from where he bought it. Kevin held onto the stock and kept telling himself what a really great company Microsoft was and that it would recover. He finally sold the stock after it was down 20%. Kevin realized he had not adhered to the CAN SLIM sell rules. Since then, Kevin relies on technical analysis alone to sell a position, and he has never sold a stock with more than a 7 to 8% loss except for the rare news-related gap-down.

He also realized that there are two problems in hanging onto losers. First, you can take a potentially devastating hit to your account if you allow a small loss to grow into a big one. Second, you can tie up your money in a laggard stock instead of selling a losing stock and putting your money into a winner. This is particularly important at the beginning of a new bull market.

Taking Advantage of New Technology

By 1995, it seemed obvious to Kevin that the Internet was going to change the way investors could get quotes and other information, but everything

was very new. The Internet was in its infancy. Kevin began by publishing bond market commentary on the Internet, but his heart was in the stock market. He wanted to share all that he had learned about making money in stocks.

In early 1996, he cofounded DBC Online. This was among the first websites where the individual investor could find quotes and news information about what was happening in the market. In the early days, Kevin's intraday market updates served as the site's home page.

CBS bought half of DBC Online in 1997 and named it CBSMarketWatch. In January 1999, the company went public. The IPO was priced at 18 and opened at 80. It ran up as high as 150 during the first day. This was the second-best opening-day performance for any IPO in history.

The website became a huge hit and is now a widely recognized site for online news and market data with over one million viewers per day from 70 countries around the world.

As part of Kevin's market commentary, he interviewed top traders. In particular, he sought out other traders of the O'Neil method. Among his favorite interviews were Bill O'Neil, David Ryan, Greg Kuhn, and Cedd Moses. Through what he had learned from the "O'Neil approach," Kevin was able to write about the market in a way that others found enlightening. Kevin's real-time commentary was seen around the world on USAToday.com, AOL, Yahoo, and other outlets. For Kevin, this was tremendously exciting. His foundation of how the market worked was built on what he had learned from reading *How to Make Money in Stocks*.

Kevin learned from his interviews that the top traders "become successful by putting their personal opinions aside and listening to the market's message. In fact, keeping one's ego in check is one of the most important aspects of trading. This becomes particularly difficult when someone who is a success in another field—say medicine, law, business, or sports—believes his success will translate to a superb trading career." As Bill O'Neil had often said, "The market doesn't know who you are, doesn't know how bright you are, and doesn't know what great college you attended. It simply doesn't care." Kevin added, "The highly successful lawyer walks into the game expecting to clean up. Often, he is the one who gets cleaned."

Always Be Prepared for the Next Opportunity

Kevin's biggest lessons from interviewing Bill multiple times for MarketWatch have been about the general market trend.

“I learned from Bill that, no matter how grim the economy or the market may appear, you must always do your daily analysis of the averages and leaders,” says Kevin. “This is because a new bull phase begins when things are at their worst, and investor sentiment is quite bearish. The initial breakouts in a new bull phase often occur in the growth stocks that end up being your genuine leaders in the ensuing move up. So making sure you get in early in a new trend is important. This is especially critical because once these new leaders break out, they can run a good amount before pausing to form their next base.

“This means if you enter after the initial breakout, you are likely entering when the price is materially extended past its most recent base. And entering an extended stock is risky because there is no technical support below to cushion any normal pullback that might occur.

“I learned this lesson in the July to October 1990 bear market. Instead of doing my daily analysis, I did not look at a single chart for months. Only after everything was obvious after the mid-January 1991 lift-off did I realize a new bull market had begun three months earlier. As the saying goes, you snooze, you lose.”

Learning how a market tops proved to be as important as getting in on a new bull run. “My first triple-digit percentage month was February 2000,” says Kevin. “I did this by holding 15–17 stocks, nearly all in the explosive technology sector. As it turned out, this was the final blow-off phase of the most powerful bull market in 70 years, though of course no one knew this at the time. In early March 2000, I noticed institutions beginning to exit the stocks that I held. This showed up on price charts as distribution days (heavy selling) in the leadership names. By taking quick action, I moved my account to a 100% cash position by March 14, which was two trading days after the March 10, 2000, top. A day later, on March 15, I mentioned this in a column of mine on a major website.”

Kevin’s long-term record has outperformed the S&P 500 by a multiple of 10 (net of a management and performance fee), according to audited reports by Big Four CPA firm Ernst & Young LLP.

Kevin says that he is “grateful to Bill O’Neil for learning so much about the market early in his career, because it significantly impacted my professional journey through the market. I believe Bill has influenced more of this era’s most outstanding stock pickers than anyone else.” Kevin’s gratitude and respect for Bill can be felt more in the silences following these statements than anything else.

• KEY POINTS •

- Check the relative strength line. If it slopes up and hits new highs, it's beating the S&P 500. True market leaders far outperform the major indexes.
- Rely on technical analysis alone to sell a stock.
- Never take more than a 7 to 8% loss from your purchase price.
- Sell underperforming stocks in your portfolio, and put the money into a winner.
- Read interviews of top traders.
- Put aside personal opinions, and listen to the market's message.
- No matter how grim the economy or market may appear, always do your analysis of the major indexes and the leaders.

Kier McDonough

Kier's first job out of college was with a large brokerage firm. He was trained to be a stock broker but didn't really learn very much about stocks: "They teach you to be a salesman and follow the internal analysts' recommendations."

In 1990, Kier got to know a broker from another firm who was a very good stock picker. When Kier inquired how he found stocks for his portfolio, the broker handed Kier *Investor's Business Daily* and recommended that Kier read *How to Make Money in Stocks*.

As Kier read through the book, he began to see how successful investing really worked. Before reading *How to Make Money in Stocks*, Kier was using a number of bad investing strategies. He bought when the market was trending down, didn't cut his losses short, and had no idea how to isolate which stocks were leading in the current market. Kier was excited as he read and reread the book, because he "had found a solid framework to help him keep in sync with the market and leading stocks."

Kier attended his first IBD Workshop in 1992 and felt empowered from the education. He began to employ the strategies and started to have suc-

cess in the market both personally and professionally. Kier moved from a large investment firm to a smaller boutique company and became a manager for a team that had diversified investments. One thing that was exciting about this smaller firm was its concentration on the new economy, which included the more innovative companies focused on technology and the consumer. Many of these newer companies had CAN SLIM traits.

Latching onto a Big Winner

In 1995, Kier bought Centennial Technologies, a Massachusetts company that made PC computer cards that provided increased storage capacity.

Earnings soared 262% and sales rose 62% for the March quarter. Because of those stellar numbers, the stock broke out of an area of price consolidation and zoomed 17% on volume that was 838% above average. Kier recognized the large institutional money that was going into Centennial and began pyramiding into the stock and added to his position.

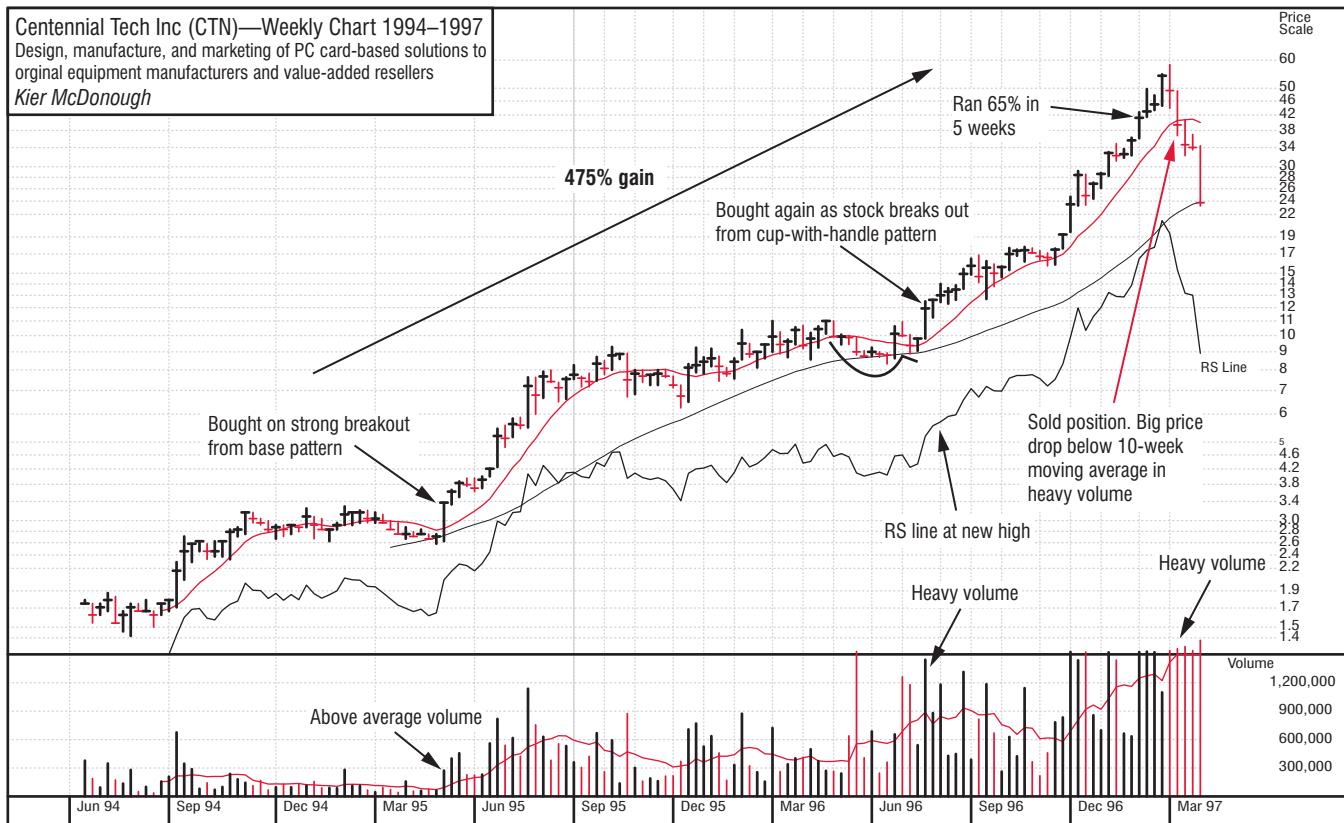
Centennial would become the number one performing stock on The New York Stock Exchange in 1996. Kier sold the stock when it went on a climax run at the end of December 1996. Centennial ran up 65% in 5 weeks and was 170% above its 200-day moving average, which is excessive. After a 21-month run, Kier locked in a gain of 475% in Centennial.

Kier personally held a sizeable position in the stock and had bought a significant amount for his investors. Kier says, “The gains from this stock had a big impact on my business, my net worth, and validated that the rules of CAN SLIM Investing, when followed correctly, do indeed work.”

After the bear market of 2000–2003, Kier realized that trading wasn’t going to be as easy as it had been in the 1990s. He decided to go to IBD’s Level 3 and Level 4 Workshops to further his market knowledge. Kier listened to the recordings from those workshops over and over and met other high level traders. He found it very helpful to exchange ideas about the market with other investors and continued to keep in touch with several of them.

In 2005, IBD was looking for a national speaker from the Boston area. Kier wanted to audition for the position because he felt it would be a tremendous learning experience. He was given a PowerPoint presentation from the IBD Education Department as the basis for his audition. Kier knows you only get one chance to make a first impression, so he spent two months writing a script and practicing before flying out to California to audition in front of an IBD speaker approval committee. The hard work paid off: Kier was unanimously approved and began teaching workshops for

Centennial Tech Inc (CTN)—Weekly Chart 1994–1997
 Design, manufacture, and marketing of PC card-based solutions to
 original equipment manufacturers and value-added resellers
Kier McDonough



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IBD nationally. Preparing to teach each workshop was “like spring training, where I had to go over the principles and basics for every event. Good habits became deeply imbedded and second nature.” Kier taught over 30 workshops for IBD and really enjoyed helping other investors learn and profit from the system.

Watch for Shoe Trends

Kier discovered a shoe company called Crocs in October 2006 that had an impressive 13 quarters in a row of triple-digit sales. The last two quarters had an EPS (earnings per share) growth of 330% and 120%. Sales had vaulted 232% and 309% in the last two quarters. Stocks that exhibit extraordinary earnings and sales numbers like that capture the attention of professional investors. Part of Kier’s research was to look for solid institutional sponsorship in any new position he might take.

Jeff Vinik, a successful hedge fund manager, owned 1.8 million shares at the time, which was up from 468 shares in the prior quarter. Kier knew that a top performing hedge fund manager increasing the size of his position was another strong indication that Crocs might make a major move. He bought the stock out of its IPO base and added to his position as the stock ran up. Kier was sitting on a gain of 378% when Crocs reported earnings on October 31. The stock sold off hard in after-hours trading due to disappointing guidance for the next quarter that was well below expectations. Kier saw the stock crashing (trading down sharply), called his trader, and sold his entire position immediately in after-hours trading, locking in a gain of 362% from his original purchase.

Through his studies of past big market winners, as well as his experience with Crocs, Kier has found that shoe fads can cause a stock to make an explosive move based on a new trend or style. Some examples that Kier has studied are Reebok, L.A. Gear, and Decker’s Outdoor, the maker of Uggs.

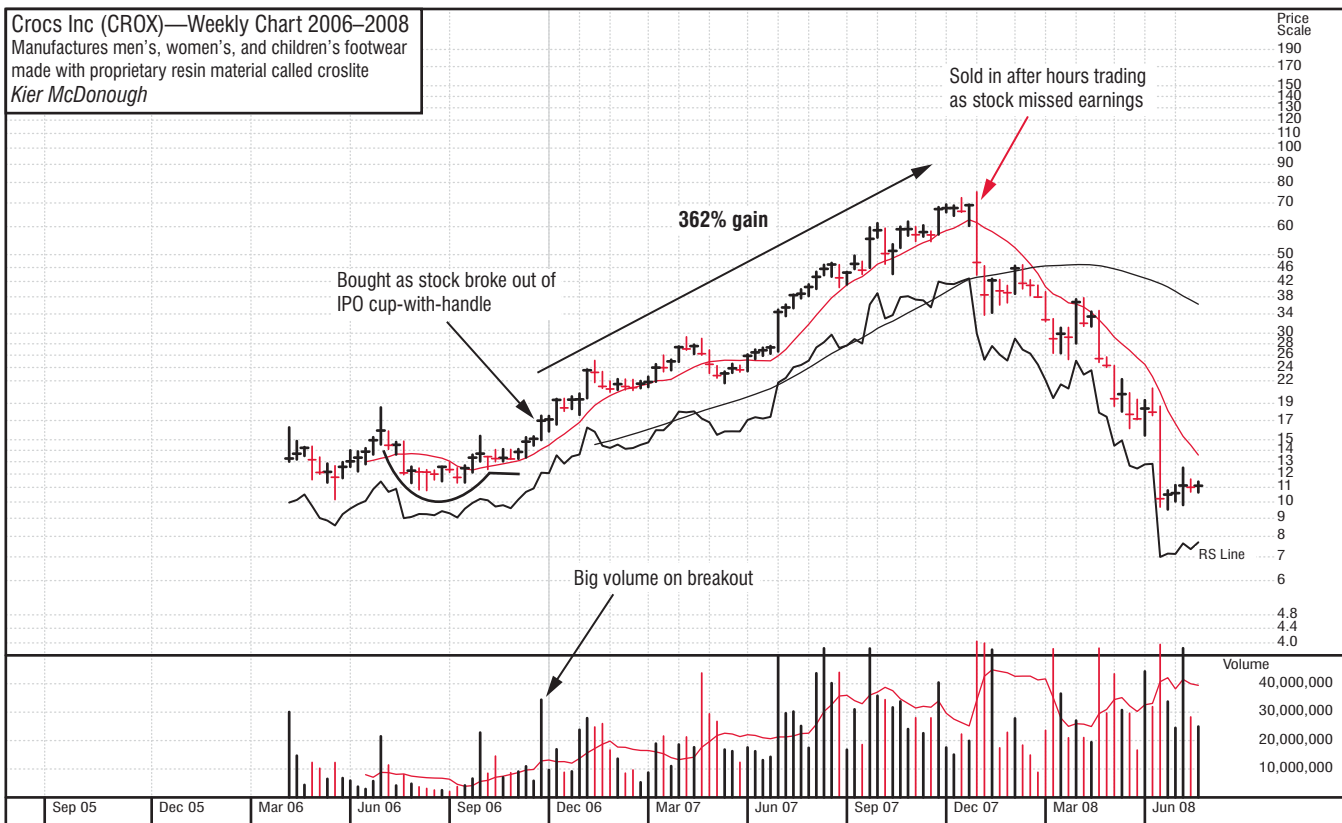
The Solar Craze

In March 2007, Kier bought First Solar, the maker of photovoltaic solar panels. The group was extremely strong at that time, as demand for alternative energy sources soared. Kier bought the stock as it bounced off the 10-week moving average line but got shaken out shortly thereafter when First Solar dropped below that line on heavy volume. He decided to sell the position at that time because earnings were coming out later that week, and one of Kier’s rules is to not hold positions going into earnings announcements if he

Crocs Inc (CROX)—Weekly Chart 2006–2008

Manufactures men's, women's, and children's footwear made with proprietary resin material called croslite

Kier McDonough



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doesn't have a profit cushion. The stock then proceeded to double but didn't offer a good entry point. Kier was patient and waited for First Solar to form another base, and then he bought the stock again. He sold the stock when it once again dropped below the 10-week line on heavy selling volume, locking in a gain of 83%.

In 2008, Kier formed a hedge fund and significantly outperformed the general market by being almost entirely in cash for much of that year's bear market. The Nasdaq was down 40% that year, and Kier kept the losses in his fund to under 5%. The rules of CAN SLIM pushed Kier to seek the safety of cash during that devastating market correction.

Kier's investment rules for his new fund would be very similar to what he had learned from his years of teaching for IBD. His top-down approach would include the health of the general market, followed by searching for dynamic companies with new products or services that were in leading industry groups. The fund would focus on top-notch earnings and sales numbers followed by technical analysis of chart patterns and price and volume as an indicator of demand for leading stocks. The overall goal of the fund was to isolate the top 1 to 2% of stocks in the market that could become true market leaders.

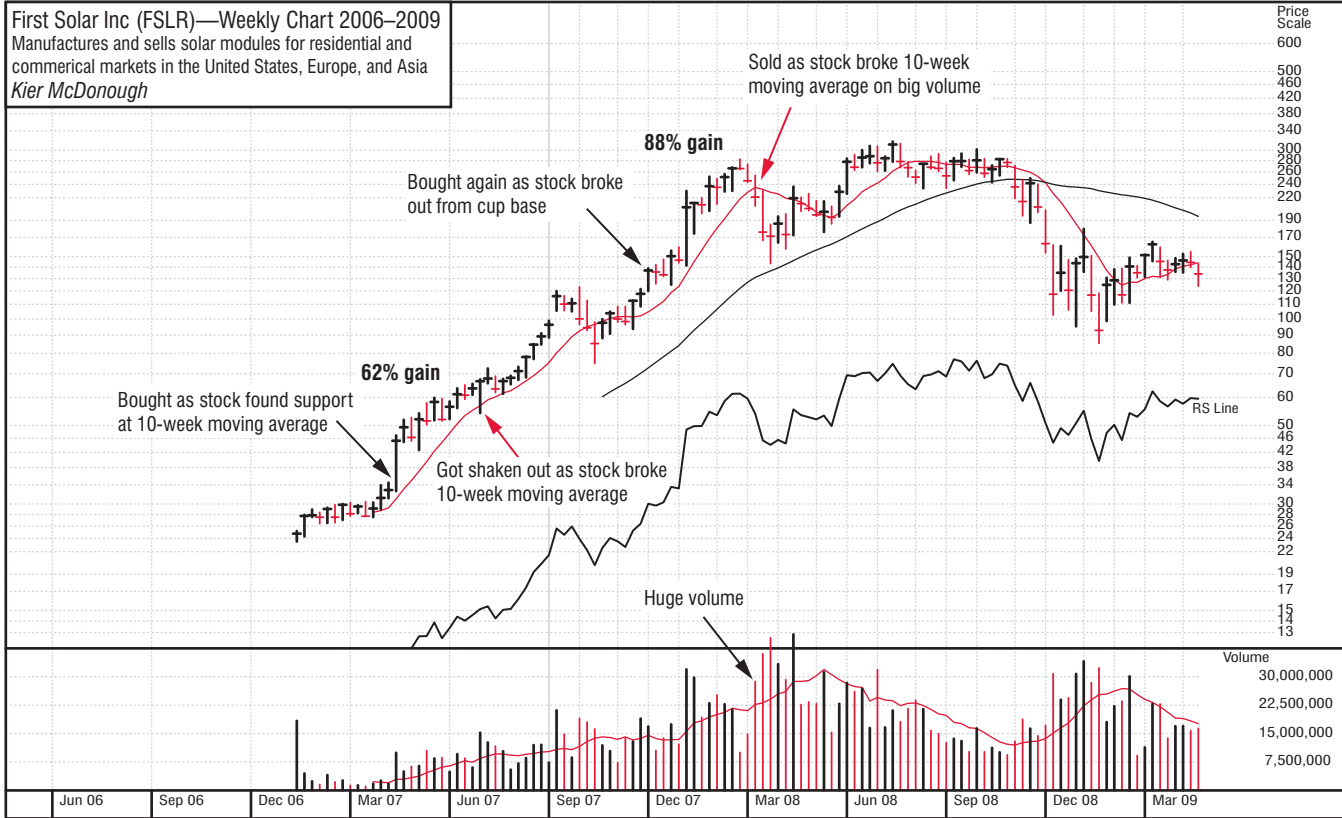
He made rules that the fund could hold up to 15 positions at a time, but the market exposure would increase only as previous positions showed profits. Margin would be used when the fund was fully invested and showing significant gains. The concentration level on any given security would be up to 30%.

Other rules for the fund included taking most profits at 20 to 25%, although true market leaders could be held for larger moves. Risk management rules would be strictly adhered to in order to protect against losses, such as a strict sell rule 7 to 8% below the initial cost of the equity. Cash levels could be as much as 100% to protect assets in difficult markets. These rules were time-tested by Bill O'Neil since the 1960s and have led to better results in the market.

In 2009, Kier underperformed and found that buying off the bottom was difficult. The market had gone through a very turbulent time, and most traders were cautious. He found most base patterns were badly damaged, "making it difficult to see what was setting up properly."

In 2010, Kier was able to find leading stocks more easily that were working in conjunction with the overall market. Some of the stocks Kier was able to notch decent gains in were Priceline, Apple, and Chipotle Mexican Grill.

First Solar Inc (FSLR)—Weekly Chart 2006–2009
 Manufactures and sells solar modules for residential and
 commercial markets in the United States, Europe, and Asia
Kier McDonough



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His Winning Routine

Kier looks for an average daily trading volume of at least 700,000 (average daily dollar volume of \$70,000,000) and tends to drift toward consumer stocks that he really understands.

During the trading day, Kier runs various screens while he is watching the overall market. He also does an extensive analysis of past big market winners. He knows that the patterns of big winners from the past repeat themselves over and over: “Like Bill O’Neil always says, the more you know what past winners look like, the more likely you are to spot a new winner as it is emerging in the current market.”

In the evening, Kier reads *eIBD*, the digital edition of the paper, and says, “The entire paper is a resource tool that has continually evolved and improved throughout the years.” Every single day, Kier creates a spreadsheet of the *Stock Spotlight* feature from the paper because he’s found that the “big leaders of any market uptrend will appear in this list.”

The *New America* article is another IBD feature that Kier uses regularly: “The paper has many sections that help an investor isolate new emerging companies. My most profitable trades have always appeared somewhere in IBD.”

Leaderboard is another product Kier uses to “have another set of eyes and research focused on the same investment philosophy as I do. As a speculator, you should not care who comes up with the idea but rather how you can capitalize on it.”

Kier finds actionable ideas with Leaderboard that dovetail with his own research: “The annotated charts are an excellent reference tool for beginners or even professional investors like me. I also find the cut list helpful during downtrending markets to look for ideas to short.”

Kier uses the weekends for studying. He scanned and enlarged the 100 charts that appear in beginning pages of *How to Make Money in Stocks* and studies one or two of them each week. It’s the desire to find the next big winner that motivates and excites him.

Kier believes in giving back and likes helping others learn more about the market. For the past six years, Kier has taken on two interns from Boston University every semester and teaches them about stocks and the overall market. He also remains involved in his local IBD Meetup community, teaching lessons several times a year over the last four years.

In searching for the next big winner, Kier notes, “Big leaders take time to develop. Most big moves typically take 12 to 18 months to occur. One has to be willing to sit through intermediate corrections that are often 20 to 25%

to capture the big returns. That's why patience and discipline are, in my opinion, key characteristics of successful speculators."

• KEY POINTS •

- Many of the market's biggest winners will have triple-digit earnings and sales.
- Watch for shoe fads.
- The patterns of the big winners from the past repeat themselves over and over.
- In the evening, read *eIBD* as a resource tool for finding the market's leaders.
- Develop patience and discipline.

Jim Roppel

Jim is the founder and managing partner of a hedge fund in the Chicago area. When you talk to Jim, his energy and enthusiasm for the market is obvious. He notes, "Opportunities in the stock market are endless if an investor is willing to do their homework, stay disciplined, and learn to be patient."

Shortly after graduating college, Jim began his financial career as a stock broker. At the time, his dad invested in biotech and drug companies. Jim thought he would try investing in medical stocks as well. His initial buys moved higher, however, when a stock's price cratered due to a bad earnings report, or when a company didn't get approval for one of their drugs, the drawdown was severe. Since Jim hadn't yet developed sell rules, he lost a great deal of money.

For several years, Jim would struggle as a stock broker, continuing to look for a winning system, even trying value investing, but he didn't have much success with any new strategy. He was determined to succeed, though, so he kept reading various books and publications on investing.

In Search of Excellence

In 1990, Jim came across *How to Make Money in Stocks* at a bookstore and was immediately intrigued. He also found *Investor's Business Daily* and

began reading it every day. Jim became such an avid fan of the paper that he would wait till midnight for the truck to deliver the papers to a local distribution center. As part of the learning process, Jim cut out weekly charts from the newspaper and glued them to the back of copier paper box lids. Then he leaned the box lids against the wall and studied the charts over and over. (These were big names in the market like Amgen and Cisco Systems.) He also cut out the New High list from the paper. Looking at this list gave Jim an indication of the overall market health. If leading stocks were continuing to hit new price highs, the market was robust.

That same year, Jim attended his first IBD Seminar with Bill O'Neil and David Ryan. Jim started really understanding the importance of fundamental criteria as well as technical buy and sell signals. He bought every cassette tape that IBD produced and would listen to these educational tapes on the way to and from work every day.

Jim realized that one of the biggest mistakes he had been making was a lack of defined sell rules. The second major problem was that he didn't have the proper selection criteria for picking stocks. He also hadn't learned to get rid of the underperforming stocks in his portfolio and move more money into the stocks that were working well. Once he began to implement a few simple rules, his portfolio returns turned around almost overnight.

Jim has attended IBD Workshops once a year and sometimes three times a year since 1990. He wanted to gain a thorough understanding of the investing strategy and base pattern recognition in order to spot potential leading stocks that were breaking out of sound patterns. He knew that buying stocks just as they are coming out of those areas of price consolidation was crucial to making large gains. Jim went over and over his notes from the workshops to cement the finer points of the system. He wanted to make money, and his desire to succeed completely overshadowed his previous challenges.

Learning from a Missed Opportunity

In 1993, Jim observed New Bridge Networks as it went up 600% in just under a year. He saw that it was highlighted frequently in IBD and was upset that he missed a big winner. But it gave Jim complete faith in the CAN SLIM Investing System and made him ready to commit some serious capital.

In 1995, Ascend Communications appeared in the paper almost every day. This was a true market leader with triple-digit earnings and sales growth. Jim had bought the stock and was sitting on a nice gain when Ascend suddenly

broke below the 50-day moving average on heavy volume in October. He sold his entire position, but by the end of the trading day, Ascend closed back above the 50-day moving average. Jim realized that he had made a mistake in selling the stock, but he didn't go back in. The shakeout had rattled him. Ascend went on to rocket higher in the following months, and Jim missed some big gains.

After that, Jim made a rule that if he gets shaken out of a position, he must go back into a stock on the same day if the stock retakes the 50-day moving average. This benchmark line is a place where large institutional players will often come in to support a position that they hold, so it is a sign of strength if a stock retakes that line with heavy volume on the same day that it falls below it.

Know When to Go to Cash

By 1999, Jim had made over a million dollars trading, but this was the roaring 1990s, just before the tech bubble burst. Things seemed a little too good to be true, and that was the understatement of the decade. The market avalanche was about to begin.

In 2000, Jim was running a \$150 million account for Morgan Stanley. He saw that the market wasn't acting right: Leaders were topping, many with dramatic climax runs. From January through early March, Qualcomm zoomed 42% in four days, Qlogic surged 75% in 11 days, and Yahoo rocketed up 90% in less than a month. This was abnormal activity. The number of climax runs that were occurring all at the same time was a warning sign to the seasoned investor that the market was topping. Jim went completely off margin and sold all of his holdings. He remembers being in a hotel in Arizona on St. Patrick's Day, all in cash, celebrating his gains. Then the crash came. Jim had avoided catastrophic losses and saved his clients and his firm enormous amounts of money as a result of heeding what he had learned from *How to Make Money in Stocks* and what he was reading in IBD at the time about the overall trend and the action of leading stocks.

After the top, people were sending Jim large amounts of money to invest, thinking that it was a great time to enter the market, but Jim let the money sit in cash, because he knew the trend was down: "When it is obvious to the masses and they begin to jump into the market with both feet, you know you've reached a major market top." Clients would call, begging him to buy Cisco Systems after it was down 40%, thinking it was a bargain, but Jim knew that buying a stock that was doing a nosedive was like trying to catch a

falling knife. Cisco ended up losing 85% of its value. IBD's research shows that former leaders correct 72% on average. That is why a buy and hold strategy is very dangerous.

Dealing with a Prolonged Downtrend

The next three years were very difficult as the ensuing bear market wore on from 2000–2003, although there were a few tradable rallies. A professional trying to make money in the market found this a most challenging time.

Although Jim knew from looking at market history that things would get better eventually, the prolonged bear almost wore him out. It was so bad that people who worked in his office couldn't wait till Friday. Watching the market week by week was excruciating and often depressing.

About the time that Jim started to seriously worry that if things didn't turn around soon, he'd be "selling donuts at the local coffee shop," the market direction changed, and a new uptrend began. It really hit home to Jim that it is often during the darkest hour that the market will bottom and begin to turn up. Since then, he has welcomed bear markets, knowing they clear the decks for new leadership and powerful bull markets. New winners are born, and Jim knows he'll be there to profit from their enormous moves.

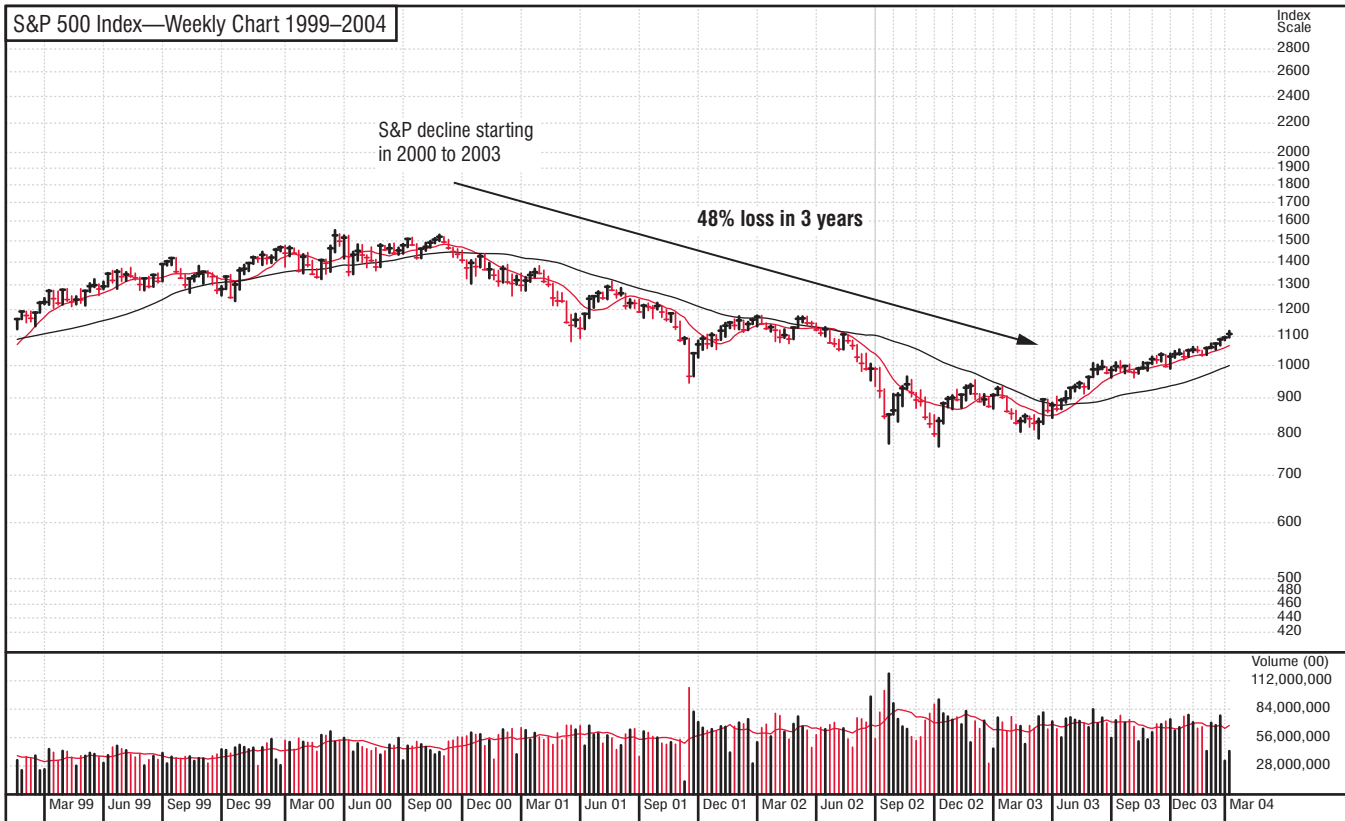
New Up Trends Bring Exciting Leaders

In December 2003, he bought Research in Motion, the maker of the Blackberry. Jim was excited about the stock because of the new technology. People could leave their office and keep up with work and e-mails. The stock's earnings soared as a result. Research in Motion is a stock that Jim would profit from a few years down the line also.

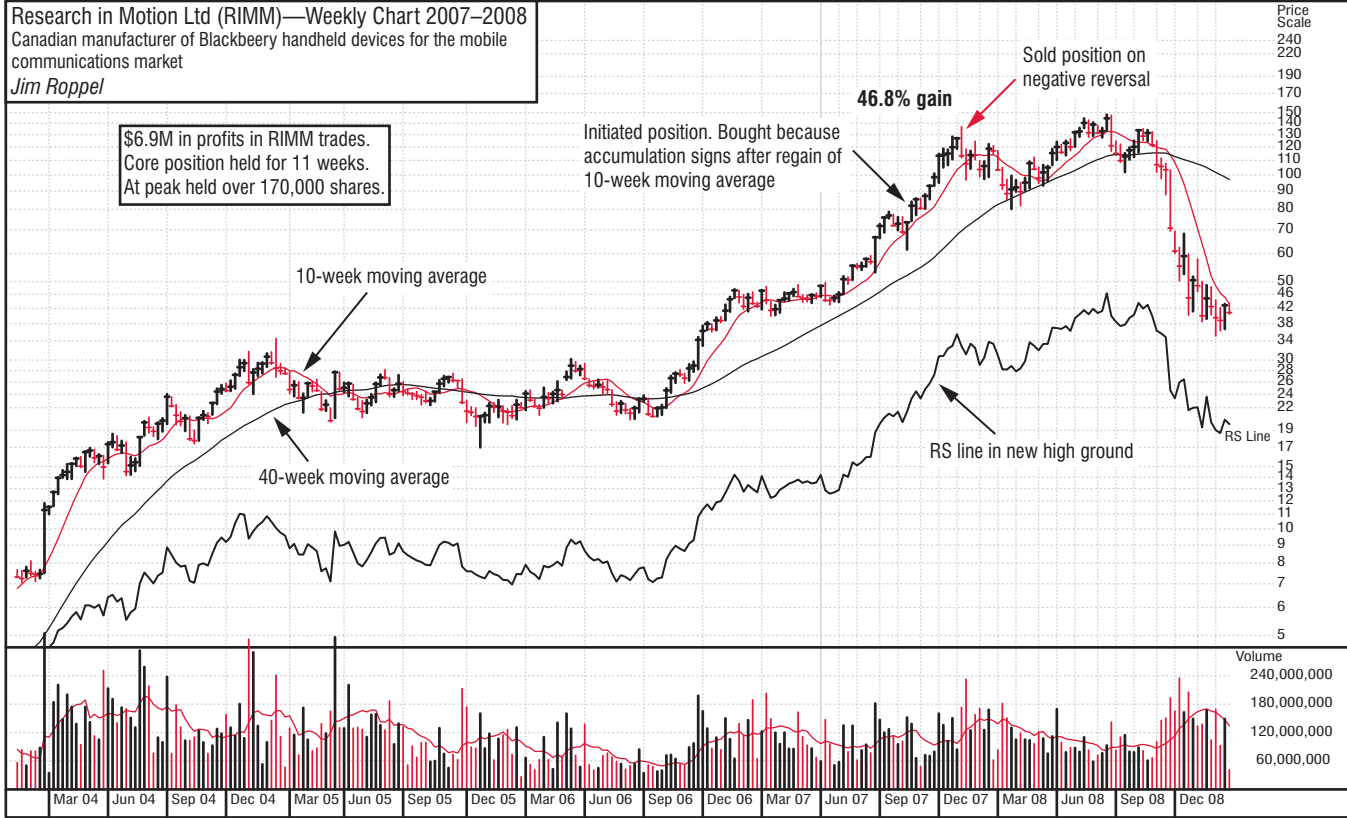
Jim bought Google in 2005. The company had the "big stock criteria" that Jim always looks for: something completely new and innovative. Google's search engine would transform the way people searched for information on the Internet.

Jim also saw something very unusual with Google's up/down volume ratio, which was 2.9. This ratio tracks the trading volume when a stock is rising in price and compares it to the volume when the stock is falling in price. A ratio greater than 1.2 shows positive demand for a stock. At 2.9, the demand for Google's shares was off the charts. Jim had found while doing research on the biggest winners from the past that they might have an up/down ratio of 1.9 or higher, but 2.9 was the highest he had ever seen (up/down volume can be found in Stock Checkup at Investors.com).

S&P 500 Index—Weekly Chart 1999–2004



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The Google of China

Baidu, which is the Google of China, first came to Jim's attention after it came public in February 2005. He didn't buy the stock because its initial base looked faulty, but he kept following it because of the unique story and because many of the market's biggest winners will have come public within the prior eight years of their big price moves.

By 2007, Baidu had more quarters of earnings and sales data, so Jim could do a better analysis of the company. As Jim did his research, he thought that Baidu looked too good to be true. "It just seemed too perfect."

Starting in the June 2007 quarter, Baidu had earnings growth of 100% and sales growth of 120%. These were massive earnings and sales numbers, and that is why Jim was able to have conviction in the stock and why he bought shares aggressively. Earnings in the following quarters were 75%, 61%, 100%, and 114%. Sales rose 118%, 125%, 130%, 122%, and 103%.

With more than 1.6 billion people in China and only a small number on the Internet at that time, Jim knew that the stock had enormous potential. Baidu also had government protection and virtually no competition. Several mutual funds, banks, and other institutional investors like Fidelity were taking large positions in Baidu, and this gave Jim greater confidence in the company.

Jim thought that Baidu was likely to have the same success that Google had as an Internet search engine. There was an exploding environment in China with a whole new group of people using the Internet. Barriers were beginning to break down in the Communist regime, and Baidu would go on to become a truly giant market leader.

Market Leaders Get Hit Also in a Downtrend

Even so, as the market turned south late in 2007, Baidu was hit along with several other market leaders. Jim sold his entire position in Baidu, knowing that even the best stocks correct when the market heads lower.

The market went down dramatically from late 2007 until March 2009. The Nasdaq suffered a loss of over 50% due to the banking and housing debacles. But Jim had been through a period like this before with the 2000–2003 bear market, and he knew that eventually the economy would pick up and that new innovative companies would emerge.

Baidu Hints of a New Uptrend

Starting in February 2009, Jim noticed that Baidu was beginning to move up again. The stock advanced 13 weeks in a row, which indicated that institu-

tional money was accumulating shares. He also noted that the RS line (relative strength line) was heading into new high ground, something that is often seen in the biggest market leaders. This meant that Baidu was outperforming the S&P 500. Subsequently, on March 12, 2009, the general market began a new uptrend. With the market acting well, Jim reestablished a position in Baidu.

On October 26, 2009, Baidu announced that it was going to change to an advertising platform called Phoenix Nest. The stock sold off heavily on the news because analysts thought earnings were going to be affected by the switch to a different platform. The next day, the stock gapped down 18% and fell below the 50-day moving average. Jim owned a large number of shares and was down several million dollars in his account. He sold a sizeable amount of his position down to the “being able to sleep at night level” and waited to see how Baidu would do in the following weeks.

Baidu traded sideways for 10 weeks but bounced off the 50-day line with heavy volume. Baidu said that the Phoenix platform would solve problems they were having with advertisers, which turned out to be good news. Institutional money went back into Baidu, and so did Jim Roppel.

Watch for Excessive Stock Splits

Baidu had a 10-for-1 stock split in June 2010. Jim reduced his position, knowing that oversize splits can sometimes make a company more lethargic by creating a substantially larger number of shares. He sold another part of his position as the stock broke the 50-day line in June and the final portion in June 2011 after the stock again pulled below the 50-day line. Jim has a sell rule that if a stock has a severe break of the 50-day moving average on heavy volume after a long run, then it must be sold.

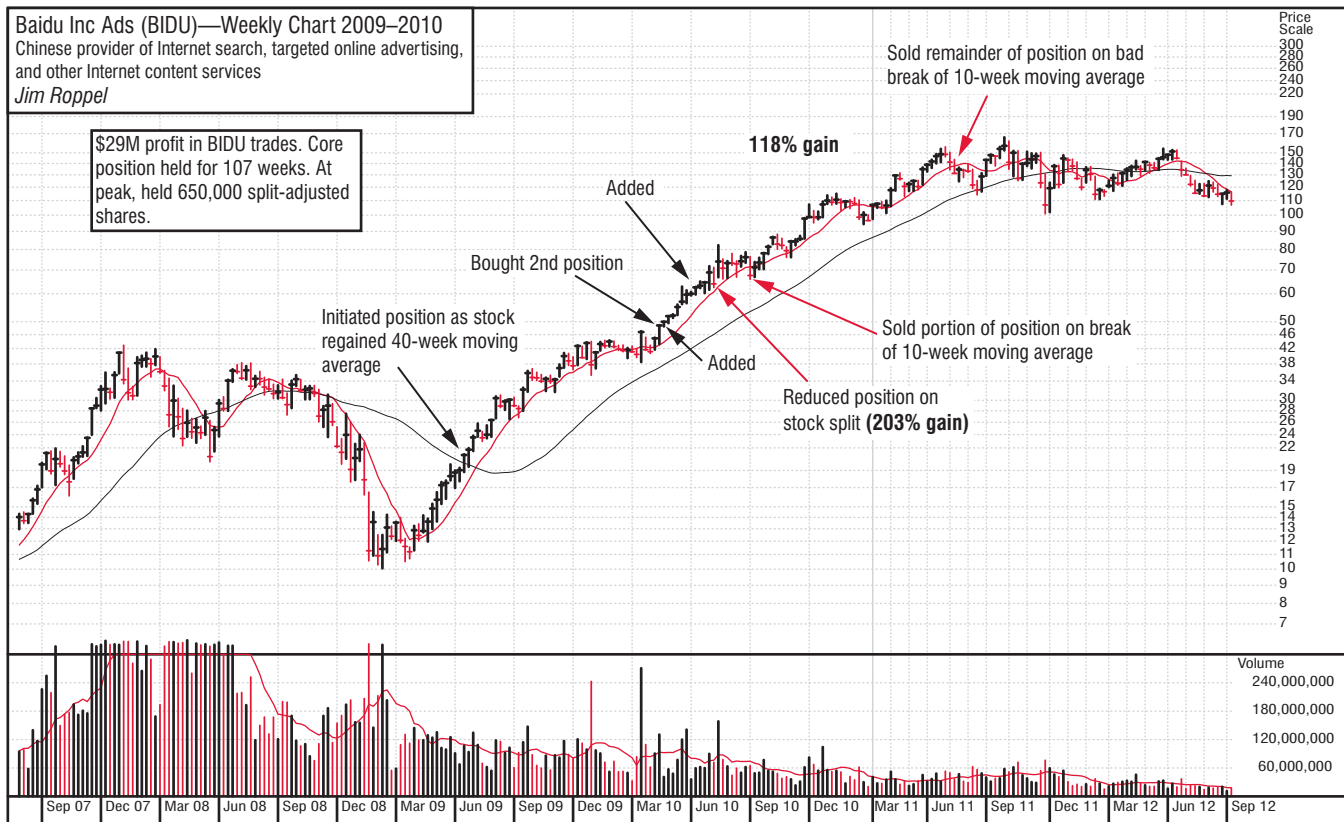
Jim ended up making just under \$30 million with his trades in Baidu. This illustrates the importance of handling a big winner correctly once you find it. Many people might discover a winning stock but end up selling it too soon or make the mistake of not going back into the stock after being shaken out of it. But this is necessary if you’re going to capture the market’s biggest leaders. And these stocks are the ones that can really change your life if you handle them correctly.

Sitting on His Hands with a Leading Stock

Jim’s overall strategy is to hold a stock for a year, though this isn’t cast in stone. He knows that a big winner may have four pullbacks to the 50-day

Baidu Inc Ads (BIDU)—Weekly Chart 2009–2010
 Chinese provider of Internet search, targeted online advertising,
 and other Internet content services
Jim Roppel

\$29M profit in BIDU trades. Core
 position held for 107 weeks. At
 peak, held 650,000 split-adjusted
 shares.



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line along its massive run. He is mentally prepared for a pullback of 20 to 26% with a truly big winner but notes that “you have to literally sit on your hands and stay disciplined as a stock pulls back.” He knows that the equity curve in his hedge fund can come down 20% or more, but this is where the professional investor must have the confidence to sit through pullbacks in order to get the big monster moves. Jim does a lot of research on a company before he buys shares, and this allows him to have the conviction to hold through periods of pullbacks.

Finding the Biggest Winners

Jim is looking for the rare stocks that will make enormous moves. When he is establishing a position in a stock, he could be investing \$15 million or more, making liquidity extremely important. Ideally, the average daily dollar volume should be two hundred million or higher (calculated by multiplying the number of shares a stock trades by the stock’s price per share). These are also stocks that are more likely to have institutional support from mutual funds, banks, and pension funds. Jim says part of the “magic sauce for finding the market’s biggest winners is high liquidity combined with soaring earnings growth.”

Baidu went on to make a move of 1,000% from March 2009 to July 2011. This only occurs when the stock is a complete game changer and dominates in its field. The biggest winners have something—a product or service that no one else has. Apple had the iPod, iPhone, and the iPad. Hansen launched the Monster Energy Drink. eBay became a multibillion dollar company with its online auction site, which offers a variety of goods and services. The exciting thing is these innovative companies show up in every new bull market cycle.

Look for a Unique Product Hitting the Market at an Opportune Time

Jim found another game changer with Netflix in 2010. Netflix knocked Blockbuster out of business. The United States was in a recession, but people could order movies from Netflix, stay home, and watch them without any late fees. Noting the company’s exceptional fundamentals and innovative business model, Jim bought Netflix in August 2010 and held for the big run, selling his final shares in April 2011 and netting an \$8.9 million profit.

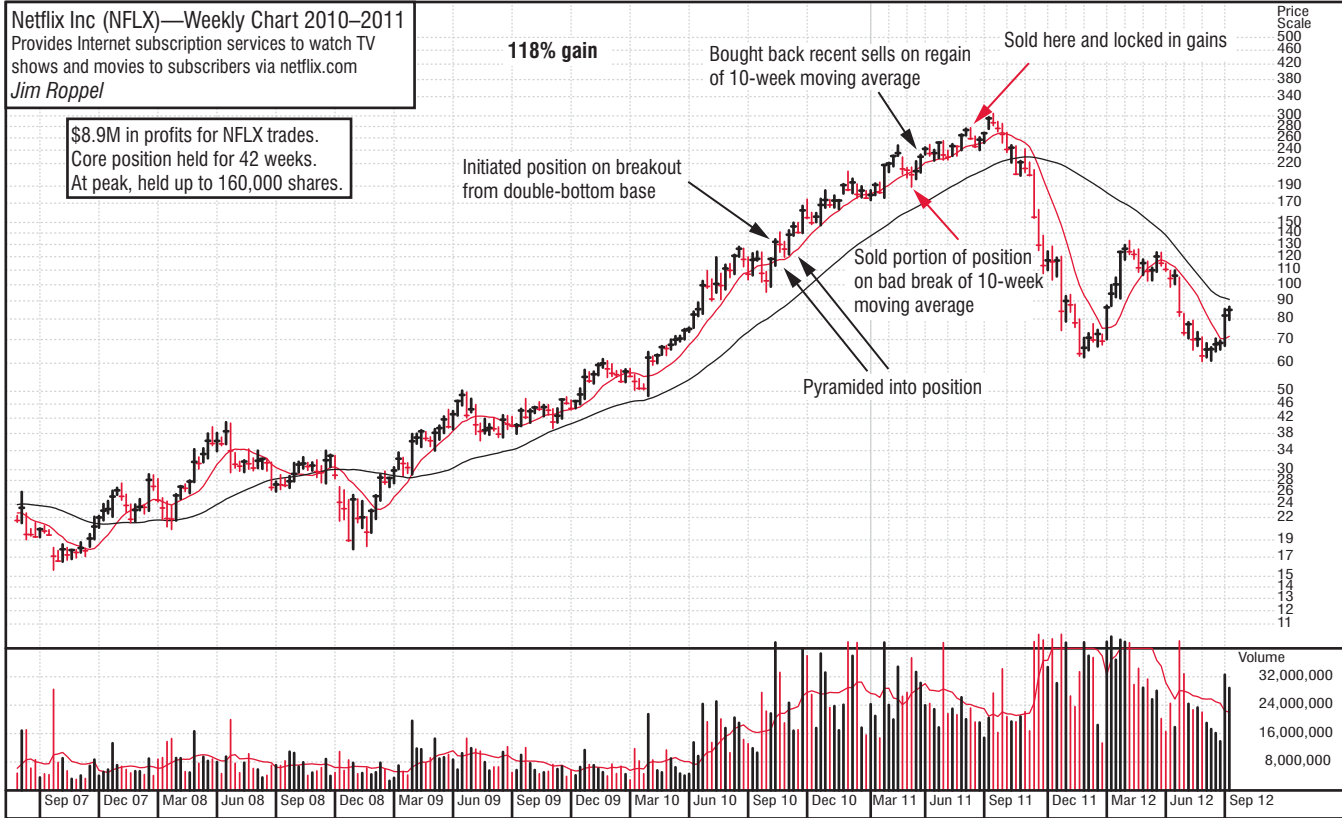
Jim’s fund was heavily margined on May 3 going into an earnings report for OpenTable. When the company reported earnings, the stock gapped down significantly on huge volume. Other leading stocks began to break

Netflix Inc (NFLX)—Weekly Chart 2010–2011

Provides Internet subscription services to watch TV shows and movies to subscribers via netflix.com

Jim Roppel

\$8.9M in profits for NFLX trades.
Core position held for 42 weeks.
At peak, held up to 160,000 shares.



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down on heavy volume, signaling some potential trouble for the market. Jim reduced his market exposure by 50% and was able to preserve the gains in his account by moving entirely to cash within a couple of days.

For the rest of 2011, the market was choppy and difficult to trade. Jim allowed himself to get swayed by all the problems in Europe, so in December 2011, when the trend of the market changed and began to head up again, he was late to the game.

Staying in Sync with the Market

Jim notes that identifying the market trend is the trickiest yet most critical part of investing. “You have to stay in sync with the market and not argue when leading stocks begin breaking out and heading higher, because it is then and only then that you are positioned to make a lot of money in the market.”

Despite mistakes, Jim has complete confidence that he will capture a piece of several new leaders in every cycle: “There are huge winners in every bull cycle, and the more you use the CAN SLIM Investing System, the more your confidence builds that you’ll be able to find and profit from a big winner.”

Jim is modest and self-effacing in discussing his successful career, reminding investors that he loses money on at least half the stocks that he buys, but he keeps his losses small and says that “it only takes a few big winners, if you handle them correctly, to significantly improve your life financially.”

• KEY POINTS •

- Pay attention to stocks that appear in IBD almost every day.
- If you get shaken out of a stock that drops below the 50-day moving average, consider going back in if it retakes that line by the end of the day.
- Look for stocks with the “big stock criteria,” something completely new and innovative that is in big demand.
- Many of the market’s biggest winners will have come public within the prior eight years of their big price moves.

- Take note of stocks going up several weeks in a row, showing institutional buying.
- Watch for too many stock splits. Several splits or an oversized split can sometimes make a company more lethargic by creating a substantially larger number of shares, which makes it harder for the stock to rise in price.
- Learn to handle a big winner once you find it.
- Many of the market's biggest winners will have high liquidity combined with soaring earnings growth.
- The market trend is the most important part of investing. Stay in sync with the market so you are positioned to profit from a market uptrend.

Eve Bobach

In 1995, Eve was browsing through a bookstore looking for stock investing ideas and happened to pick up a copy of *How to Make Money in Stocks*. She had always found the complexity and speed of change in the markets fascinating and was immediately hooked by growth stock investing possibilities.

Later that year, Eve attended her first advanced IBD Seminar and was excited to meet Bill O'Neil in person. She took her copy of *How to Make Money in Stocks* up to Bill after the workshop and asked for his autograph. He signed, "Buy the best companies with great earnings, coming out of bases." It's something Eve has never forgotten and often reads to remind herself of what to look for in the very best stocks.

Over the years, Eve has attended dozens of IBD Workshops. She says they "reinforce everything that is in Bill's book." From them, she has learned what to look for in the technical patterns and key fundamental factors in leading stocks.

In early 1996, Eve bought Whole Foods Market after the stock followed through on a high-volume breakout from a cup-with-handle base and made some nice gains. At the time, Whole Foods had only 35 stores, with plenty of opportunities to expand. Some of the key fundamental numbers included: latest quarter earnings +41%; latest quarter sales +24%; and Accumulation/Distribution Rating A. (This rating measures whether a stock

is under institutional accumulation or buying. The rating goes from A to E, with A being the highest.) Whole Foods was one of Eve's earlier successes, and it's a stock that she would profit from more than once. Eve admits to being a bit of a health food nut, so she was familiar with the store long before it became a household name. It helped her have conviction in the company and its possibilities.

This success taught Eve a valuable lesson: whenever possible, she visits the store of a company that she is evaluating, or buys a product to see what she thinks of it. She admits to having a closet full of various products purchased for market research, such as the K-Cup coffee makers that Green Mountain Coffee Roasters sells, Lululemon athletic gear, and Michael Kors accessories.

Jim Roppel met Eve through mutual friends and recruited Eve to assist with a new small cap growth fund that he started in 2011.

It Takes a Structured Approach

Eve is very methodical in her approach to the market and investing. She is structured and analytical while following a relatively straightforward routine. She has streamlined the process to what is most essential.

Eve checks the global markets, futures, and pre-market prices and news on stocks in the portfolio as well as watch list stocks to see how they are doing before the market opens.

After the market opens, Eve watches the major indexes and the action of market leaders. Throughout the day, she monitors the 100 or so stocks that she feels might have the potential to become leaders and runs screens to find stocks with exceptional fundamentals that are rising on unusual volume.

An hour and a half before the market close, Eve closely monitors the action of the indexes, market leaders, and stocks on her watch list. Key reversals can happen late in the trading day, so she pays close attention during this critical time.

After the close, Eve takes a break and works out. She runs or does Pilates and feels this is a healthy way to recharge after the market action. Eve also enjoys spending time with her family and friends; this helps put everything into perspective.

In the evening, Eve reads through *eIBD* and does more online research. She is always looking for new trends and future leading stocks.

If the market has started a new uptrend, Eve tracks the stocks that broke out after the most recent follow-through day. The stocks that break out early

and perform the best a few weeks after a new uptrend begins are the ones that may lead the new rally. Eve also monitors how the breakouts act to determine the health of the rally. If a number of breakouts stall or begin to fall below their pivot points, it may lead to a failed rally attempt.

To help assess the health of the market, Eve also monitors distribution and accumulation days on the major indexes as well as price performance and duration of the current rally relative to other market cycles.

Eve conducts a post analysis of her trades and has found that one of the worst mistakes is to take a small profit in a big market leader. These are the stocks that should be held for the bigger run. Eve bought eBay out of its IPO base but was shaken out and never went back in, missing out on the stock's big move.

Once you have found a market leader, it's important to put enough capital into it to make substantial profits. Your best-performing stock should be your largest holding. eBay taught Eve a lesson.

As a result, she has learned to always be prepared to buy a stock back if it subsequently turns around and starts to make another move.

Avoiding Emotional Trading

In order to control possible emotional trades made in the heat of the market action, Eve has her rules written out and nearby. When she makes a trade, she asks herself what rule is making her buy, sell, or hold onto a stock.

One way to remove emotional trading is to buy on the daily charts and sell on the weekly. The daily action tells you when a stock is breaking out, but the weekly shows the big picture that is valuable in assessing how a stock is acting. To capture the significant moves, it's important not to be shaken out by the day-to-day market gyrations, instead focusing on the intermediate trend. A weekly stock chart helps put this into perspective.

Eve feels it's important when entering a position to write out some hold rules and have sell points established ahead of time. This takes possible indecision about when to sell, out of the equation.

Eve also trades in increments to avoid overreacting. She does follow-up buys on positions that are doing well.

She is currently doing a study of the 1998 market and the characteristics of the leaders at that time. Eve studies past markets to help her identify future market leaders. She examines the technical action that all big leaders have in common. One thing that she has noticed is that many of them have

breakaway gap-ups early in their run. These big gap-up moves in price can make investors nervous, but they are often characteristic of true market leaders.

Handling Buyable Gap-Ups

Buyable gap-ups should only be entered in stocks exhibiting strong fundamental strength in an uptrending market. The model stock book of stocks that IBD has researched for over 130 years has many examples of stocks with gap-ups that went on to make big moves in the market, but these companies were also leaders in their industry and had strong earnings and sales along with other key fundamental criteria. A more successful buyable gap-up play occurs in a market leader that has already proven itself but is rocketing higher due to a positive earnings report.

When large institutional money goes into a stock, it is a good indication that they have faith in the company and its products or services and see the likelihood of success in the future.

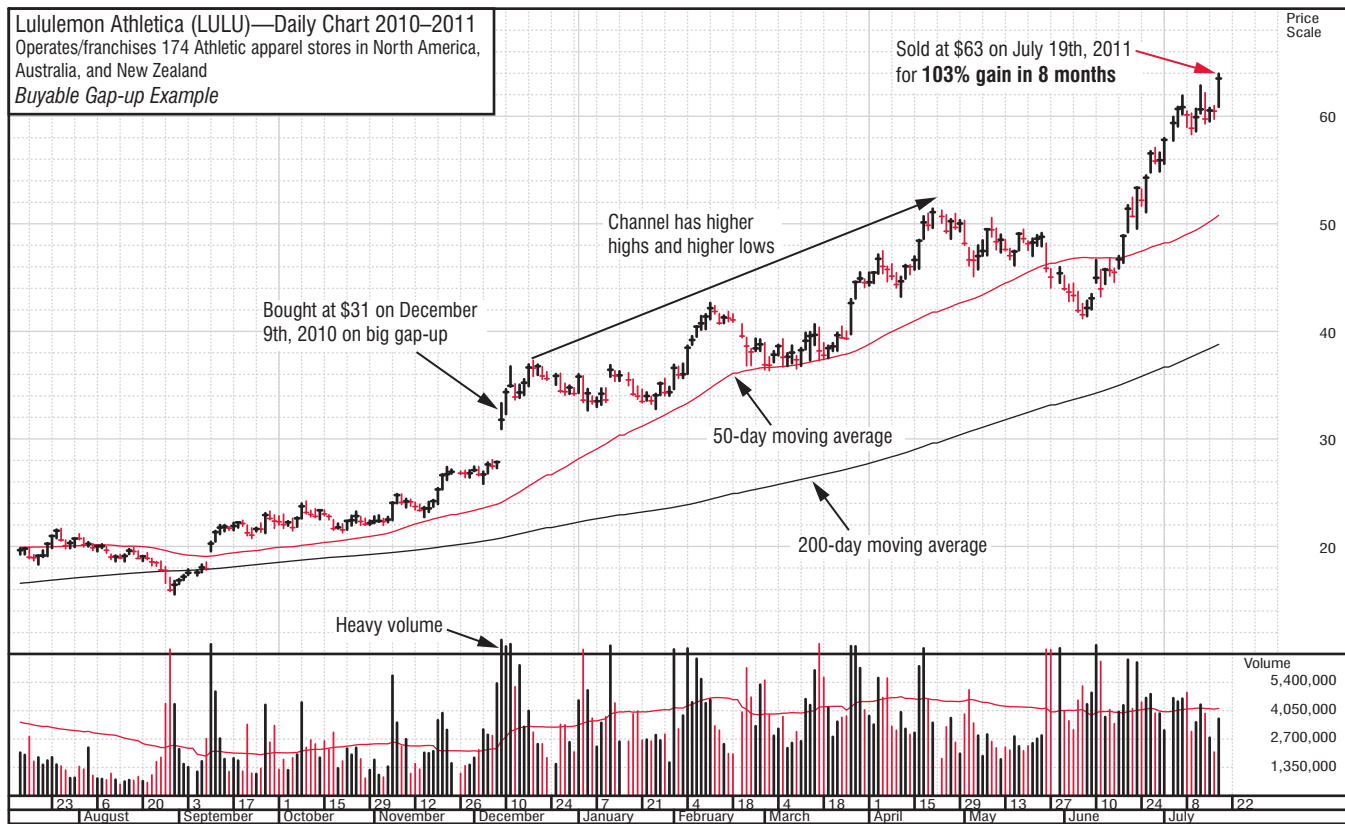
• KEY POINTS •

- Track stocks that break out right after a follow-through day to determine the health of the rally and to track potential big winners.
- Your best-performing stock should be your largest holding.
- Have a set of written rules near your computer to avoid emotional trading.
- Gap-ups should only be entered in stocks that are exhibiting strong fundamental strength in an uptrending market.
- When evaluating a company, visit a store or buy some of their products.

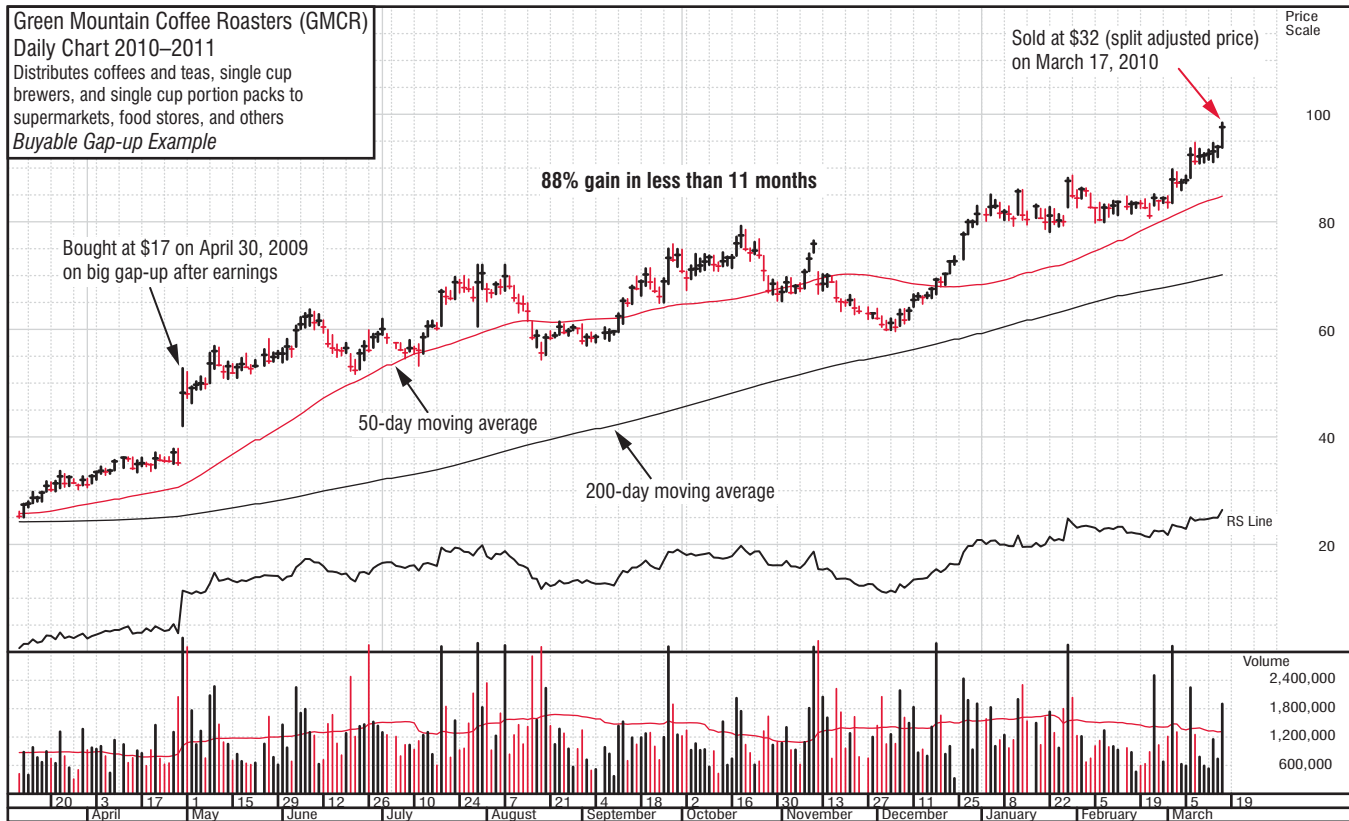
David Ryan

David's first introduction to the stock market was from his dad, who saw investing as a way to pay for a college education. Since David was pretty young at the time, his dad would talk about companies like Disney so David could relate to them better. When David was 13 years old, he bought his

Lululemon Athletica (LULU)—Daily Chart 2010–2011
 Operates/franchises 174 Athletic apparel stores in North America,
 Australia, and New Zealand
Buyable Gap-up Example

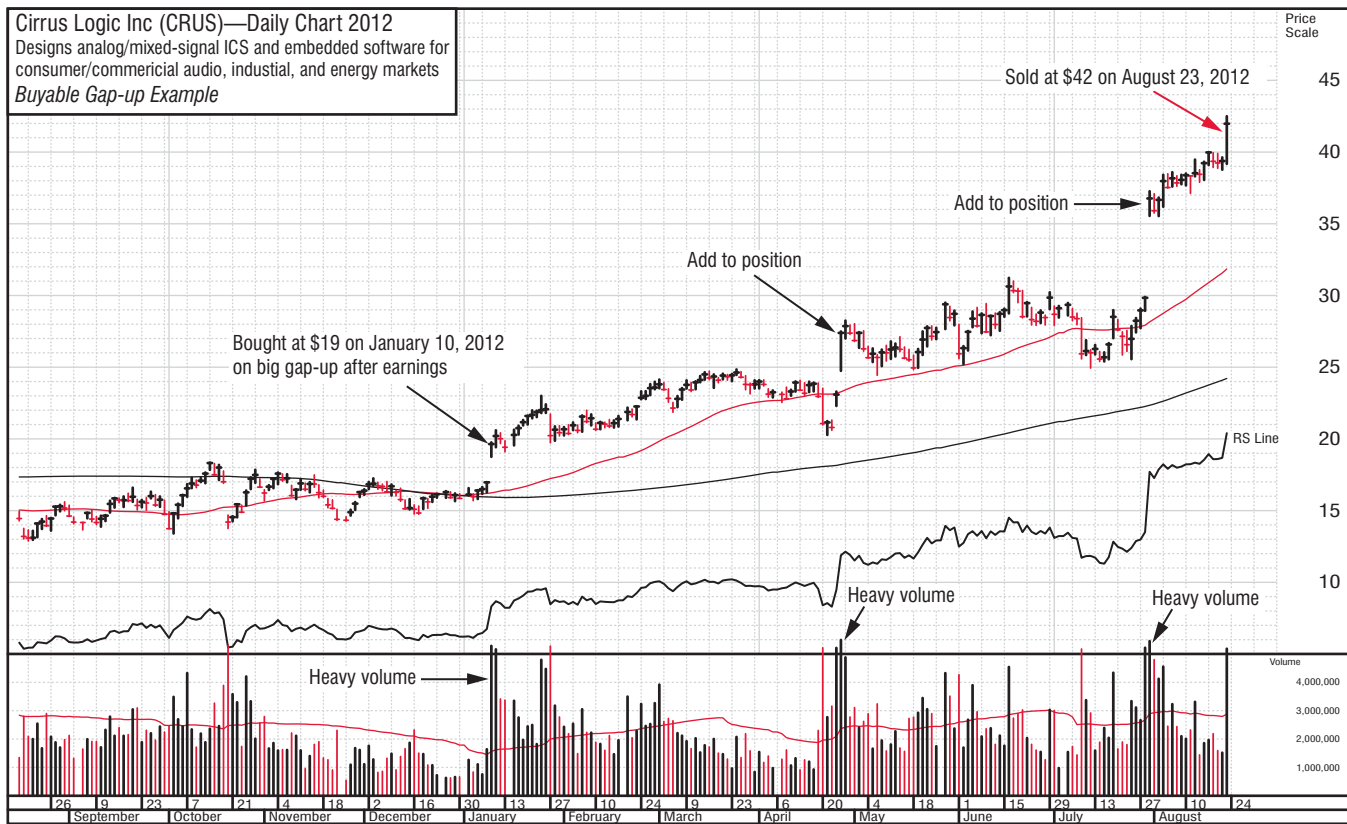


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Cirrus Logic Inc (CRUS)—Daily Chart 2012
 Designs analog/mixed-signal ICS and embedded software for consumer/commercial audio, industrial, and energy markets
Buyable Gap-up Example



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first stock, 10 shares of Hershey's, the maker of Chunky candy bars. David followed his stock and others in the market, wondering why some stocks would go up and others would go down.

His fascination with the market continued through high school and college. After hearing Bill speak at an investment seminar in Century City, David took a trial of Daily Graphs. When he went down to pick up the chart book each Saturday, Bill O'Neil was often there answering people's questions. David listened to these conversations, riveted.

Once he graduated from UCLA, David showed up at the O'Neil offices and offered to work for free. He met with Kathy Sherman, Bill's executive assistant at the time, who recognized David's energy and enthusiasm for stocks and the market. David left thinking nothing might come of his visit to the O'Neil office, but by the time he got home, there was a message on his phone machine saying that Bill O'Neil wanted to interview him. A few days later, when Bill was interviewing David, he asked him what he wanted to do in five years. David wasn't really sure, but replied, "I know you've been successful. I just want to learn all that I can."

David started in the institutional area of the firm doing research and learning everything about the CAN SLIM Investing strategy. A new bull market began in August 1982, and David started investing, using what he had learned since joining O'Neil + Company®. He says, "I did pretty well for about a year and a half but was making lots of mistakes and gave back most of my gains." David went back and studied his trades and came to the conclusion that he was buying stocks that were too extended. He decided to become extremely disciplined and from then on, "My performance really started to take off."

David rose to national attention by winning the U.S. Investing Championship three times between 1985 and 1990. This competition was sponsored by a former Stanford professor and involved real money in real accounts. Each year, approximately 300 contestants, including portfolio managers, market letter writers, and individual investors competed to see who could achieve the best returns.

David says, "The CAN SLIM principles are all laid out for you, but it's your job to adapt it to your comfort level and make it work. It will require some studying, but to be successful in anything, you have to be willing to put in the time."

From 1982 to 1985, one of David's primary responsibilities was working closely with Bill to advise the firm's 500 institutional clients on individual

stock selection. David also managed several investment portfolios for William O'Neil + Company.

David worked with Bill for nearly 17 years, and though he respected Bill enormously and had learned an incredible amount from working with him, he felt it was time to “stretch his wings,” so he started his own hedge fund in July 1998.

David feels his longevity as a professional investor stems from the fact that he controls risk as much as possible and doesn't let losses get out of hand, noting that “if it is your own account, you might be able to take more risks, but not when you're dealing with people's retirement money and their family wealth.”

He likes investing in retailers because “you can go into a store or restaurant and get a good feel for them.” David usually trades around a core position in a stock, so if he owns 20,000 shares, he may cut that down to 10,000 if the stock is basing or the market is pulling back and then “ramp shares back up as the stock begins to take off again.”

In recent years, he's had success with stocks like Chipotle Mexican Grill, Apple, and Caterpillar.

Know the Story

The key factor that will help you stick with a winning stock is to make sure you know its underlying story. What is making the company successful? What are the key concepts that will keep it highly profitable? Will the company go from having 250 stores to over 500 in the next few years? Are they producing a product that is in big demand?

David feels that even if someone has another job, it's important to have a trading account of some kind: “Try to put in a half hour of study each day and begin to put the CAN SLIM principles to work. IBD does a great job of highlighting the best stocks in the best groups. All you need are one or two great stocks in a year, and you can achieve some outstanding results.”

He says that “CAN SLIM Investing is the fastest way to make money in the stock market, but the key is to have discipline. There are some straightforward rules that you must follow.”

David is passionate about the market and investing, “and this has taken me through some difficult, challenging markets.”

He also adds that while it's great to make money, there are other things that are more important: “Faith, family, and friends are the most valuable. Keep it all in perspective.”

• KEY POINTS •

- Make sure you understand a stock's underlying story. What is making the company successful? What are the key concepts that will keep it highly profitable?
- Try to put in a half hour of study each day and begin to put the CAN SLIM principles to work.
- All you need are one or two great stocks in a year, and you can achieve some outstanding results.

Portfolio Managers: Mike Webster and Charles Harris

*“Fast as the wind, quiet as a forest, aggressive as fire,
and immovable as a mountain.”*

—SAMURAI BATTLE BANNER

This saying mirrors the quiet but swift decisions that a professional must make while trading. Mike and Charles have been portfolio managers for O'Neil Data Systems, Inc., for over a decade. They are hard-working and passionate about the market, and both are polite and unassuming despite the tremendous amount of success they have had in their trading accounts, both professionally and personally.

Mike Webster

Mike had been interested in investing since he was very young.

“When I was 24 years old,” Mike says, “I read Peter Lynch's *One Up on Wall Street*, which had a profound impact on how I looked at a company's products and services. Lynch was a buy-what-you-know guy, and that just made sense to me, so I was on the lookout for that great next product to give me an edge. Around that time, I took a tour of the Robert Mondavi Winery up in Napa Valley, and I was blown away. I couldn't believe the amount of detail that went into every aspect of the business, from how they avoided diseases that would kill the grape vines down to inventing new nonspill wine bottles. I went home and ordered all of their annual reports and read them cover to cover. Though I was too new to investing to really understand the data, I was absolutely convinced that this was going to be a great stock. The

only problem was, I didn't have any money. I was just a couple of years out of college and living paycheck to paycheck. I wanted to buy a round lot of 100 shares but didn't have enough money, so I started saving and scrounging up whatever I could. Meanwhile, the stock didn't wait for me; it ran up from \$7 to \$14. I realized I was going to miss the stock's move if I didn't act fast, so with all the money I had, \$540, I bought my odd lots. As I saved more money, I continued buying more shares, and the stock more than doubled by the time I finally sold. I learned a great deal from that experience. Always be on the lookout for new products; they are what drive a stock's move up."

The Christmas Present That Changed His Life

For Christmas that year, Mike's parents bought him *How to Make Money in Stocks*. "Little did I know this book was going to change my life," After he read Bill's book, he recalls saying to himself, "I've just got to work for this guy."

Mike remembers thinking he had won the lottery after he was hired by William O'Neil + Company to work in the research department. Not long after being hired by the firm, he was in an accident, and his car was totaled. As he sat on the curb waiting for his wife to pick him up, he says, "I felt like I was given a second chance in life and didn't want to waste it. Right then I wrote down my short- to long-term goals. The key goal was to become a portfolio manager for Bill. I looked at that sheet every day, and it kept me highly motivated, working long hours every day."

Soon after that, Bill gave an inspirational speech to the research department. Mike approached Bill afterwards and told him he wanted to be a portfolio manager. Bill said he wasn't really looking for a portfolio manager but said, "Put some of your trades together, and come talk to me."

Mike assembled several past trades and current stock ideas and nervously entered Bill's office. He says, "I've never been so nervous in my whole life. Bill was pretty tough on me." Mike felt "devastated and demoralized" after the meeting but realized that the charts he had given Bill were stretched and not properly sized, so Bill thought a lot of stocks Mike was investing in had charts that were very wide and loose (volatile price movements) when in fact they were not.

A longtime employee asked Mike, "How much time did Bill spend with you?" When Mike responded an hour and a half, she said, "Bill wouldn't have spent that much time unless he saw something promising in you. Hang in there."

Training with the Master and Learning to Live in the Moment

Mike kept plugging away and had more meetings with Bill regarding his trades. Bill saw improvements in how Mike was handling stocks and that he had listened to his feedback. In late December 1999, after reviewing several of Mike's trades that were well executed using the CAN SLIM Investing System, Bill offered Mike a job as a portfolio manager, making Mike's dream come true. The following year, Mike was lucky enough to start working in Bill's office, where he stayed for a few years. He says, "That was such a special learning experience and very motivational. No one works harder and is more positive than Bill. He is a great role model and mentor."

After working with Bill for awhile, Mike realized that Bill lives in the moment as a trader: "One week Bill could dislike a stock and then a couple of weeks later turn around and start buying it. That flexibility has kept him in phase with the market for over 50 years. He doesn't care what he said in the past. When the facts change, he changes with them." He recalls a lesson Bill taught him when reviewing a mistake that he had made. Mike round-tripped (letting a gain fall back to the purchase price) a big position, letting a large gain evaporate. Bill said, "You always need to be flexible, bending like a tree in the wind. Don't freeze up. If a stock starts acting poorly, start selling at least some of it, then reassess and sell more if warranted."

"Bill isn't afraid to make mistakes and doesn't really care what anybody thinks. He doesn't have an ego but has more confidence than anyone I've ever met. If Bill makes a mistake, he'll correct it quickly, but if the stock turns and sets back up, Bill will go back in and buy the stock back, only with slightly more money than the first time around, putting him in the offensive position."

"Bill has the ability to truly capitalize on the market leader. Once he has a profit cushion with a stock, he will sit with it and add at logical points as the stock rises in price. He spreads his purchases over several weeks and months. This great stock-picking skill and patience completely separates him from all other traders."

Always Be Looking for New Ideas

Another thing Mike learned from working with Bill is to always be looking for new ideas. Bill looks at hundreds of charts over the weekend, and so does Mike.

Mike says, "Studying hundreds of charts on a regular basis gives you an edge. You start to notice that stocks have different characteristics, just like peo-

ple do: some are slow and steady, others are erratic, and there is everything in between. Once you can key into the stock's character, you can know what to expect, when is it acting normal, and, more importantly, when it breaks character. This is a skill that anyone can learn if you study enough charts."

"The only time I said no to Bill as a portfolio manager was when he asked me to teach the IBD advanced workshops," says Mike. "I was absolutely terrified of public speaking." Bill didn't understand Mike's fear but encouraged him by saying, "You know everything about the system backwards and forwards."

Mike continued to struggle with his fear of public speaking but began teaching the advanced workshops with Bill and really saw value in the seminars from the feedback he received from the attendees. Bill always said to everyone who helped out with the workshops, "We are getting as much out of the seminars as other people because of all the tremendous work we put in before we teach. It forces us to really follow the system."

Day-by-Day Stock Chart Simulations Are Extremely Instructive

Mike thinks the workshop animations have helped him the most as a trader: "At the Chart School Seminar that I teach with Charles Harris, we go over animations taking stocks day by day through their move. We stop at various points, letting people know what we would do with the stock. When I'm conflicted with a decision in a real trade, I imagine I'm going over it at a seminar, and it gives me clarity."

For a newer investor, Mike cautions, "Don't try to make a lot of money right off the bat. Making money shouldn't be the primary goal. Learning the system should be, then the money will come. The worst thing that could happen is that by a fluke, you make a lot of money with bad habits in a more forgiving market." He suggests, "At first just trade with 10% of what you were planning on investing. Learn to make mistakes and how to correct them before investing a larger portion of your capital."

Look for Historically Similar Market Periods

The study of bull and bear markets helps illuminate the larger up and down trends that the market goes through and repeats decade after decade. Helping investors understand the overall market trend has been one of Bill O'Neil's goals since before the inception of the newspaper in 1984. Having historical data to help interpret the market's trends over the years is enormously helpful.

“If you enjoy studying the market and past winning stocks, eventually you’ll find a perfect precedent for a current time period. In early 2003, I realized that a chart of the Dow from 1929 to 1932 looked just like a chart of the 2000 to 2002 period on the Nasdaq; in fact, they were almost identical. I also found a precedent from the bull market that started in March of 1933, in which the Dow looked just like the Nasdaq in March of 2003. So I used that precedent as a roadmap to trade aggressively during that time frame. That is why Bill has us studying past stocks and markets because nothing ever changes.”

Creating Highly Useful Investment Tools

Over the years, Mike has created many products used for the company. His first was Stock Checkup for Investors.com. He also created the IBD Composite Rating because Bill wanted a way for investors to quickly evaluate the overall strength of a stock fundamentally. The Composite Rating combines key characteristics like earnings growth, profit margins, the level of institutional buying over the last 12 weeks, and other fundamental data designed to help investors find the best stocks faster. Stocks are given a numerical rating from 1 to 99, with 99 being the best.

Mike also helped develop the MarketSmith 250 Growth Screen. He admits to being a “screen junkie,” so this product was created to save people time with just one comprehensive list of stocks worth researching rather than building countless screens. This list has over 30 different themed screens that are combined into one list that filters for technical and fundamental stock data like price performance, earnings, liquidity, return on equity, and pre-tax margins, among other criteria. Mike says, “Learning how to screen properly takes years, and we wanted to speed up everyone’s learning curve. The product was really created to save people time. I use it every week.”

Pattern Recognition, another product that Mike helped develop for MarketSmith, uses algorithms to create chart base patterns and to identify buy points. Through a lot of hard work, Mike was able to get the computer to identify and draw the base. If an investor is newer to chart reading, this helps locate the stocks that are consolidating and getting ready to break out. For the more seasoned trader who already knows how to read charts, it’s a time saver: “Having the percent from the pivot, depth, and stage of the base is great—it’s like using a calculator instead of doing the math by hand.”

Market School is a new seminar that Mike teaches with Charles Harris. Mike says, “Charles and I worked with Justin Nielsen to come up with sev-

eral buy and sell rules based on the market's price and volume action to give us a guideline for how deep to be invested. We knew that a follow-through day would get us in the market. And a lot of distribution days would signal a top. But the problem was the period of time in between a market bottom and a market top. Bill has a great sense for how deep to be invested based on his decades of experience, but we aren't Bill. So with countless hours of back-testing, we came up with a set of rules that work extremely well. Our goal was to be in line with how Bill trades and looks at the market."

A product that Mike didn't work on but that he really likes is Chart Arcade. He said his 10-year-old daughter got him hooked on it. It's a stock market game created by the MarketSmith team, where investors can buy or sell historical charts based on price and volume action. Mike says, "You get immediate feedback whether a stock you bought or sold was the right decision, and this can really speed up your learning curve."

(Investors can practice their skills for free at Chartarcade.com.)

Mike's overall advice is, "Read *How to Make Money in Stocks*, and stick to the CAN SLIM Investing System. Put in a few hours of study each week, and you will be able to have that extra spending money or a larger amount of money to retire on. But if you want to truly change your life, it's like everything else: it takes a lot of time and hard work, but it pays off."

• KEY POINTS •

1. Always have an up-to-date watch list.
 - Create a ready list with stocks that are nearing a buy point.
 - Keep a universe list for stocks that are worth following but are not quite near a buy point.
 - After you purchase a stock, have a sell, hold, and add plan for each stock.
 - Plan your trade, and trade your plan.
2. Watch for a sign of strength.
 - If the indexes are living above the 21-day moving average, the market is strong.

Charles Harris

Charles was a commercial real estate appraiser working toward his MAI designation (Member of Appraisal Institute), but he was very unhappy with the work and wanted to find a new career. He had always been interested in the stock market, so when he saw a posting on the UCLA jobs board for William O'Neil + Company, he decided to apply. Charles got a rejection letter that thanked him for his application but said he wasn't quite right for the job. A few years later, William O'Neil + Company was looking for an MBA to work as an analyst in the research department. Although Charles did not have an MBA, he applied for the position anyway, and this time he prevailed. At the time he was hired, Charles was primarily a value investor and was "dabbling in the market and investing in low P/E stocks without much success. I didn't even know who Bill O'Neil was back then."

Charles' initial plan was to get his foot in the door, spend a year or two getting some valuable work experience in the financial industry, and then move on to a job as a securities analyst. Toward that end, he began pursuing his CFA designation.

His responsibilities in the Research Department gave him access to stock data and detailed reports of individual stocks prepared by securities analysts from all of the major investment firms. Charles figured that with access to these reports, he would be able to pick the very best stocks and make a killing in the market: "When I read these reports that were so well researched and so persuasive, I called my wife and told her, 'We're going to be rich!' Instead, I lost half of my money in about three months. I was very naïve, but it taught me a very important lesson: Don't rely on the opinions of others. Do your own research, and come to your own conclusions."

From September 1995 through the end of 1996, Charles didn't have much overall success with investing, despite trying to learn all that he could about the CAN SLIM Investing System. Although he was able to pick some winning stocks, he had a tendency to hold onto his losers far too long, and as a result he lost money on a net basis.

Assess Your Trading Strengths and Weaknesses

So in December 1996, he sat down and had a serious discussion with himself. He contemplated, "Who am I as a trader? What are my strengths and weaknesses? What are the basic rules that I must follow if I am to be successful?" Charles wrote down a whole set of trading rules based on a post analysis of his actual trades over the prior year, as well as the teachings of

some of the great trading legends, including Bill O'Neil, Nicholas Darvas, and Jesse Livermore. This became his "Trading Manifesto," which detailed his personal strategy to take advantage of his inherent strengths and laid out the trading rules that he would be bound to from that day forward. Immediately after that, Charles began to have "big success" in the market, running his personal account up over 1,500% over the next 18 months.

Unfortunately, Charles learned the hard way that great success often results in an inflated ego, and during the brief bear market that took hold from July 1998 through early October 1998, Charles lost three-quarters of his money: "My failure was brought on by my own hubris, and I continued to trade stocks despite the fact that the environment was treacherous, and the odds were against me. I had lost my discipline and self-confidence and almost gave up trading altogether, figuring that my earlier success was just beginner's luck." Having earned his CFA designation several months earlier, he applied for an analyst position at a money management firm.

Up Over 1,000% in 1998

Thankfully, Charles did not receive an offer, because as the market turned in October 1998 to begin the last leg of the great bull market, he went back to the rules that led to his earlier success and reclaimed both his discipline and confidence. In 1999, Charles had a huge year in his personal account and was up over 1,000%. Upon hearing of his success in the market, he remembers Bill saying to him, "Just remember, we all put our pants on one leg at a time." Based on his own successes over the years and having worked with dozens of traders, Bill knew that successful traders often get a "swelled head. Maybe he was trying to warn me not to get too carried away with myself. I wish I would have listened."

Toward the end of 1999, Charles approached senior management and expressed his desire to be a portfolio manager for Bill. A couple of weeks later, after his trading results were reviewed, Bill took Charles to lunch and explained that he didn't need a portfolio manager but was looking for someone to support the current portfolio managers as a research analyst. Bill added, "Maybe in the future, you'll get some money to run."

In January 2000, Bill moved Charles to a cubicle just outside his office and had him research stocks that he and the portfolio managers were interested in. During the first eight months of 2000, Charles was up over 800% in his personal account. After observing his trades, Bill gave Charles money to manage in June 2000, which coincided with the beginning of a brief, yet

incredibly strong countertrend rally. After just six weeks of managing money for Bill, Charles' account was up more than 50%. "I was on top of the world," he said. Little did Charles know, that was the beginning of a long, dry period.

"My hubris had once again raised its ugly head. I had become overconfident and loose with the rules. When the market broke badly in September 2000, I ignored the fact that the bear market trend had resumed and kept trading anyway. I had done so well up to that point that my ego was totally out of control. I had lost all my discipline. I was like an addict."

Charles ended up giving back the bulk of his profits in his firm account and lamented that his personal account took a huge hit as well. "There is no substitute for experience, and until you've been in the investing battlefield, it's hard to understand this," he says. "The market was cracking wide open. The Nasdaq dropped over 45% in just four months. I started losing huge amounts of money. The only thing that saved me was my experience from the 1998 bear market, when I had nearly blown up my account. I knew I was out of control, so I just started wiring funds out of my personal account so I couldn't trade. I ended up preserving about two-thirds of my capital. The rest of the money...gone. This was demoralizing and left a big impact on me."

Never Break the Rules

Charles went back to his trading plan and, with a little time and a few "good" trades, recovered his discipline and confidence. He has learned the hard way to "always maintain your discipline and keep your ego in check, because breaking rules in the market will cost you a lot of money." He added, "I've really learned the importance of trading in line with the trend of the market, and to not draw down too much because it's so hard to come back psychologically after you've dug a deep hole. It can take years just to get back to even...what a waste."

When Charles and Mike Webster first became Portfolio Managers for Bill, they worked side by side in his office for two years. Each day they would compare their trading results. "I guess it was an ego thing, a way of measuring yourself. But in truth, comparing my progress with Mike put an enormous amount of pressure on me. Even if I was trading well, I'd feel crummy if he was doing better than me. But if I was beating him, I'd feel just fine, even if I wasn't really trading that well. It made absolutely no sense.

"I learned to go into a cocoon and stay isolated, like the legendary trader Nicolas Darvas, or the 'lone wolf' Jesse Livermore, so that I wouldn't com-

pare my trades or my results to anyone else's. You don't have to be a genius to do well in the market, but you do have to keep your ego under control so you won't break the rules and make careless mistakes." To his credit, Bill isolates all of his Portfolio Managers and doesn't let them know where they stand in performance relative to each other. He knows that doing so would only put additional pressure on them.

Learning from Your Weaknesses and How to Overcome Them

The many years of teaching investing workshops have made Charles realize that every trader has their own inherent strengths and weaknesses: "For some, it's very difficult to cut losses. Other investors may not have the patience or fortitude to hold on for the big move. They satisfy their ego by locking in their profits early and miss out on the big money."

"To overcome weaknesses, Bill has taught me to

1. Admit that you have some shortcomings. Some investors refuse to take responsibility for their own results, and they end up never succeeding.
2. Do a post analysis of your trades; your weaknesses will pop right out.
3. Write down rules to help you overcome your trading flaws."

"In writing down my own rules and strategy, I really defined what style of trading comes most naturally to me. I am more of a swing trader. I am most comfortable taking profits into strength when my analysis of the stock's action tells me that a pullback is in store, and I tend to buy on pullbacks to the major moving averages or other support levels in stocks that have proven that they are market leaders. I am a much better singles hitter than a homerun hitter. That style is consistent with my personality, so I don't fight it. Bill has proven over the years that he is a great homerun hitter, so he may trade a little differently than I do. That's okay. Bill said to me a long time ago, 'If what you're doing is working, don't change it.'"

"Bill has been an inspiration in many ways. For one thing, his work ethic is unparalleled. There is nobody at the firm who works harder than he does. He is very flexible when it comes to the market and individual stocks. He can change his mind on a dime, and yet he has conviction when it's appropriate. One of the things that I admire most is the fact that he has never blown up his account, which is rare among traders. He will never hesitate to cut a loss if his stock starts acting poorly, no matter what he thinks of the company or how much he likes the stock. He is one of the few investors who made a fortune trading his own money. Most of the wealth in the financial

field is based on trading other people's money. Bill is proof that making a fortune in the market can be done . . . it's just a matter of stringing together a few big winners and handling them properly. Of course, that's easier said than done."

A Few Big Winners Over a Lifetime Can Make a Fortune

"Bill's genius is that he truly has a knack for finding that special stock in a bull cycle that turns out to be a gigantic winner, and he has the ability to capitalize on it and make the big money. He doesn't always find every great stock; he misses some. I remember him telling me once that 'you can't kiss all the babies.' But you only need a few big ones over your lifetime to make a fortune. Look for the game changing stock, a company that has something really new and unique. Bill devised CAN SLIM to help investors identify these types of stocks.

"I'm up over 40 times my original principal since 2001 in a non-margined personal account. This is during a period when the broad market indexes have been relatively flat on a net basis. To achieve gains like this, you need to trade the windows of opportunity that present themselves and not give it all back in a correction.

"The stock market has changed my entire life. Everything I own and have been able to provide for my family has been the result of trading successfully. Anyone can do it, but you have to really want it and work hard at it. It's not easy, and it doesn't happen overnight. There are no shortcuts. You have to believe in yourself, and you have to believe in your trading strategy. With patience, hard work, and discipline, you will be successful."

• KEY POINTS •**On Market Psychology**

- Detach your ego from trading.
- Don't focus on your last trade if you made a mistake.
- Don't aim for perfection.
- The best traders are detached from their results. Focus on the CAN SLIM System.

On Trading

- Don't put too much money in a thinly traded stock average daily volume of 400,000 or less..
- Don't enter a trade that doesn't have a high probability of winning (a stock should be coming out of a proper base pattern on volume that is 40% higher than average).
- You can have a lot of mistakes and still make a lot of money.
- Stay out of bear markets; it's too easy to lose a lot of money trying to fight the overall trend.

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• CHAPTER •

Grandmaster: Legendary Investor Bill O'Neil

“Victory is reserved for those who are willing to pay its price.”

—SUN TZU

“The arrow flies straight and far because of the strength and quality of the bow. The success of the arrow is dependent on its relationship with the bow. The relationship we share with our teacher is unlike any other we will have in our lives. It is through our loyalty and commitment, our attention to even the slightest instruction coming from the master, that we will see maximum benefits in our own development.”

—GRANDMASTER HEE IL CHO, 9TH DEGREE BLACK BELT

A grandmaster is one who has achieved the highest level. In the investing world, Bill O'Neil is a legendary trader and one of the most successful investors of all time. But what sets him apart from some of history's greatest traders is his dedication to teaching and helping other investors.

William J. O'Neil

The Man

Layers of complexity are often found in highly successful people. Bill is a man who is not easily defined, whose work ethic was developed at an early age. He came from a modest background and always held down part-time jobs. Whether it was delivering the newspaper or working in the produce section of a local grocery store, Bill O'Neil has worked very hard most of his life.

He is also an intensely private man, somewhat reserved and modest, but compelled to help other people, even if this puts him in the limelight. Bill scoffs at the notion that he is anything other than a regular guy and is uncomfortable with too many compliments.

His simplicity, sense of humor, and down to earth attitude can be observed by his choices in watches; he often wears a Mickey Mouse watch when he speaks in front of an audience and needs to keep track of the time. In other somewhat amusing instances when he has forgotten his watch, Bill will borrow other people's watches and lay them on the podium to help him keep track of time. Bill has often inadvertently put several of these watches in his pocket and forgotten about them after he finishes speaking. IBD National Speaker Justin Nielsen works with Bill on special projects and has had to hunt down many "borrowed watches" from Bill and return them to their rightful owners before they go through the wash cycle.

But underneath Bill's unassuming nature is a fiercely driven man. In 1958, Bill started his career as a stock broker at Hayden, Stone & Company after a tour in the U.S. Air Force and college.

In 1960, Bill was accepted to Harvard Business School's first Program for Management Development (PMD).

Determined to succeed, Bill studied the greatest stock traders of all time: Gerald Loeb, Bernard Baruch, Jesse Livermore, and Nicolas Darvas. As a young stock broker, Bill also studied Jack Dreyfus, who, at the time, was outperforming all of the other funds. Jack was a great bridge player and had a sharp mind that Bill admired, so Bill sent away for the Dreyfus prospec-

tuses and began studying all of the stocks that the fund bought. Bill found that they were buying stocks that were reaching new highs, which seemed crazy at first. Bargain hunting was a common myth in the investing world.

Bill also began to realize from his extensive studies that Jack was brilliant at reading charts, and this would forever change the way Bill approached investing.

Bill began an in-depth study to find out what all of the biggest stock market winners had in common before they made their big price moves. He went back to 1950 and realized that the biggest winners all had similar fundamental traits in common. Out of this incredibly detailed research, Bill created the basis of the CAN SLIM Investing System and became the top performing broker in his firm.

At the age of 30 (the youngest at that time to do so), he bought a seat on the New York Stock Exchange and started Century Information Sciences to program and analyze stock data. During that same time, he started William O'Neil + Company, Incorporated which became a successful investment research firm.

In 1972, Daily Graphs was created as a weekly printed book of stock charts.

In 1973, Bill founded O'Neil Data Systems, Inc., to provide a high-speed printing and database publishing facility.

Investor's Business Daily was launched in 1984 (called *Investors Daily* at the time) and became the first national daily newspaper to exclusively focus on stocks, revealing data to individual investors that was, prior to the creation of the paper, available only to professional investors.

In 1998, Daily Graphs Online was launched as a comprehensive equity research tool, providing investors for the first time a chart with all of the key fundamental data on one page, making research much faster.

In 2010, the next generation of Daily Graphs, MarketSmith, was launched. And the evolution continues with Leaderboard services that have the highest screening capabilities so far.

The Legacy

Bill could have chosen to keep all of his market discoveries to himself but instead chose to share this knowledge, knowing it would help countless investors for decades to come, and very likely into perpetuity, since market psychology never changes. This is Bill's philanthropic gift to investors that could never be quantified or ever measured.

His legacy is compounded by another unique and very comprehensive study into the most successful people of all time. It's a database of the common traits of legendary people, from Aristotle to Oprah. From those studies came IBD's *Ten Secrets to Success* which can be found in *IBD* every day.

Investor's Business Daily

When asked why he created IBD, Bill says, "I saw a need among the general public for better information about the financial markets, especially the stock market. Having already spent 30 years in the investment business, I'd read about all there was to read on the market and how it worked, including all the major newspapers that devoted space to the subject."

"As good as some publications were, they all lacked an understanding of what works in the market and what doesn't. With *Investor's Business Daily*, we sought to fill this void and, in doing so, help people get more out of life." The cornerstone of IBD has been the ability to screen for early emerging trends in both the general market and stocks.

Every feature that is in IBD includes things that Bill feels are important for investors to understand. In many ways, IBD is Bill's written trading plan of how to be a successful investor. IBD went online with Investors.com in 2000 and added enhanced research and lists to help investors find great stocks.

Bill has authored numerous books including:

How to Make Money in Stocks (first edition 1988)

24 Essential Lessons for Investment Success (2000)

The Successful Investor (2003)

Business Leaders & Success (2003)

Sports Leaders & Success (2004)

Military and Political Leaders & Success (2005)

How to Make Money in Stocks: The Complete Investing System (expanded sixth edition, 2011)

The Discipline

Bill has always eaten healthfully and worked out regularly. As legendary trader Jesse Livermore said, "A good stock trader is not unlike a well-trained professional athlete who must keep the physical side of their life in perfect form if they want to keep at the top of their mental form."

Bill also has a work ethic that would frankly exhaust most mere mortals. An enormous amount of Bill's success appears to be sheer genius, but he is a man who is willing to outwork almost everyone, and this gives him the edge. Bill has said, "The most successful people are those willing to do what others are not." He also has a laser beam focus of attention. When he was a younger man, this must have been somewhat intimidating.

Whenever I have had discussions with Bill, whether it concerns a business matter or a chart that I might have asked a question about, he has an ability to focus like few people I have ever met. Bill's ability to focus so intensely is part of his investing success. He can study a chart and can zero in on its intricate details in a way that is truly amazing.

The Teacher

When Bill started IBD, he knew that investors needed to be introduced to the concepts and features, and he also knew that if he spoke in front of large groups, that more and more investors across the country could learn an investing system that would help them financially. So for years, Bill would give free workshops and share his market knowledge. It is impossible to track how many people Bill influenced through these free workshops, but the numbers are large, given the quantity of testimonials that have come into IBD over the years. For many people, hearing Bill speak changed their lives forever.

Over the years, Bill has taught at countless IBD Workshops and always stays afterwards to answer questions from attendees until the hotel where the event is held literally turns off the lights in the room. He is always incredibly patient and wants to answer everyone's questions.

It is the same when Bill speaks in front of an IBD Meetup Group. I have had the great privilege of opening many of these Meetup groups in the Southern California area with Bill. He is giving in every situation, staying after the presentation to help answer questions, patiently addressing each investor's concerns until the last question is answered. When the local library or community room where we were holding the Meetup had to close, Bill would graciously continue the conversation and take it outside to the curb, patio, or whatever was available, always wanting the individual investor to find success in the market.

You will never find Bill on the finest golf courses in America, nor sailing on an expensive yacht, but you will find him giving endlessly of his time so

that other lives may be transformed by what he has learned from over 50 years in the market.

The kind and sincere part of Bill O'Neil is that he is a great teacher at heart, and he knows that other people can transform their lives because he himself has done so.

Through Bill's generosity, combined with his tireless work ethic, he has influenced thousands of professional and individual investors through his teaching.

Of all the legendary traders, Bernard Baruch, Jesse Livermore, Nicolas Darvas, Gerald Loeb and others, it is my personal opinion that Bill O'Neil's discovery and creation of the CAN SLIM Investing System will be talked about for decades to come, and will have more influence on those that want to learn about the market than any other trader in history.

The Legendary Trader

To become the very best trader you can be, imagine that Bill O'Neil is standing behind you, looking over your shoulder, and ask yourself: Would you execute the trade you're about to make? Would you sell? Why?

Did You Follow the System?

"Do or do not. There is no try."

—YODA, JEDI MASTER, *STAR WARS*

To become the very best trader you can be and achieve the highest returns possible, stick to the time tested CAN SLIM Investing System. These are not Bill's opinions but how the market and leading stocks have actually worked, with research going back to 1880.

If Bill's portfolio managers stray from the CAN SLIM rules, he will call them on it. Imagine he is doing the same for you. Reading IBD daily will help reinforce these investing principles and familiarize you with parts of the paper that identify top CAN SLIM stocks that are performing well in the current market.

Be Flexible

"The stiffest tree is most easily cracked, while the bamboo or willow survives by bending with the wind."

—BRUCE LEE

Bill is never married to an opinion, and this includes the overall market trend as well as leading stocks. He remains flexible, which is one of his greatest strengths as a trader. He is not stubborn and feels no need to be right. Ego is the death of success, and Bill learned this a long time ago watching many investors lose everything because of an inflated ego and the need to be right all the time.

As an example of Bill's flexibility, he was very bearish in 1999 before the last and final run that the market made. But when the market issued a follow-through day in September of 1999, he totally changed his mind and accepted what the trend was telling him.

Bill could also be glowing and excited about a stock but will immediately move on if he's wrong and not give it another thought. He has no need to be right, and makes no apology if he is wrong. Bill simply moves on to what the market is telling him. He truly lives in the moment.

Charts Tell You What Is Really Going On

Bill looks at charts above everything else and is always searching for new ideas. He studies charts and goes through many graphs on the weekend. Bill flips through them until something catches his eye about the pattern. He has a nearly photographic memory of charts going back in history, and this is probably his greatest gift. Bill can see a stock setting up in a pattern that looked the same as another winner from previous decades. This skill can be learned, perhaps not to Bill's level, but it can be achieved by studying previous market winners and recognizing what they looked like prior to making their big price moves. One hundred charts are annotated with chart patterns and descriptions of the overall market trend in the beginning pages of *How to Make Money in Stocks*.

"Every stock is like a person; it has a personality. I study stocks the way I study people. After a while, their reactions to certain circumstances become predictable."

—JESSE LIVERMORE

"Some stocks are steady movers; others have more volatile price swings. Know what you're dealing with."

—WILLIAM J. O'NEIL

What to Look for in a Big Winner

- Is the product something people want or need? Are the earnings and sales increasing? This will show you that there is a desire for the product or service. What is their competitive edge in the market? How unique are the company's products or services? Do they dominate, or are they easily copied? Look for a company that has something that is completely innovative and revolutionary that the masses will want to buy.
- Volume is a measure of supply and demand and can be seen on a chart. Look for spikes in volume that are well above average, showing institutional buying in a stock. This will signal to you that the professional investors are committing serious capital in the company (free charts can be found at Investors.com).
- Institutional money is the only thing that will drive a stock's price higher, so always look for volume, the higher the better.
- Return on equity in many big market leaders will often be 30%, 40%, 50%, or higher. This shows how efficient a company is with its money and is often an indicator of how successful a stock may be if other key fundamental factors are in place, such as double- or triple-digit earnings and sales.
- Increasing quarters of earnings and sales is another indication of strength. (This fundamental data can be found in Stock Checkup at Investors.com.)
- Bill remembers similar base patterns and what they looked like in previous bull markets. Study chart patterns at IBD University for free at Investors.com to learn what the basic chart patterns look like.
- Focus on the very liquid stocks that trade at least one million shares per day, because these are companies the institutional investor can enter. They must establish large positions and cannot put money into thinner traded companies.

When Bill is asked how he always finds the biggest winner in every cycle, he says modestly, "I never thought of it that way, but here's what I look for: After 4 to 6 weeks of a strong new uptrend, you've identified stocks that have the big earnings and sales and are setting up in the proper chart patterns, but you still may not know which one or ones will be the big market

winners for that new cycle. Some may look good, but they may not work. You have to cut the ones that aren't performing well that you buy when other stocks in your portfolio are acting strong. It's like weeding a garden: you are pruning to find the very best stocks. If you're keeping your rules and looking for stocks with the strongest earnings and sales with truly innovative products setting up in the right chart patterns, you'll end up with the next Google or Apple.

"I make a lot of mistakes, but if a stock doesn't work out, I sell it, period. If the general market is right and you're buying top quality merchandise, your stocks should be working, particularly in the beginning of a new bull market.

"The biggest winners should make themselves obvious to you. Apple was our best performing stock for the last eight years. We didn't necessarily catch onto it right away because the prior three years to the company taking off, Apple hadn't done tremendously well in terms of earnings. But once the earnings began to go up sharply and we began to understand their outstanding products better, we realized that this was a very unusual and innovative company.

"Every new bull market cycle brings in a new industry group. Part of your job as an investor is to uncover what it is leading the market. Look for IPOs that are gaining market share and showing big earnings and sales far above other stocks in the current market. Many of these stocks will show up in the *IBD 50*."

• KEY POINTS ON MONEY MANAGEMENT •

- Figure out which stocks are the true market leaders and put the most amount of money into them.
- Shift money from your lesser performing stocks into your winners.
- Consider using margin to enhance your performance, but only after you have more experience in the market and only in a healthy bull market.

Opinions

“Markets are never wrong, opinions are.”

—JESSE LIVERMORE

“You cannot go by what you think or feel. You must see what is actually happening in the market and with leading stocks.”

—WILLIAM J. O'NEIL

Lessons from a Market Legend

- Set goals and always stay positive.
- Many of the market's biggest winners will shake you out. You have to find a way to get back into them once you have identified them to be the leaders in the current bull market cycle.
- Never chase a stock; wait till it offers an alternative entry, such as another base pattern or a pullback to the 10-week line. And make sure that it continues to outperform other stocks in the market in terms of earnings and sales.

The Eternal Optimist

“Choose the positive. You have a choice and are master of your attitude. Optimism is a faith that leads to success.”

—BRUCE LEE

“The opportunities are there for anyone willing to put in the work. Each cycle is led by brand new inventions or entrepreneurial companies that are going to change the industries that they are in . . . somebody will always come along with a different and better way of doing things, and every new bull market will have a Google or an Apple.

“If you put into practice the principles from these success stories, don't be surprised if you change your life for the better.”

The Method of Our Success

W. Scott O'Neil

Back in the early 1960s, when my father began William O'Neil + Company, the investing landscape was vastly different. Mutual funds were at their early growth stage, whereas today the big funds dominate the market, and anyone can open an online trading account. In the interim, countless investing methodologies have come and gone. For example, the Buy and Hold strategy—a favorite of the bullish 1980s and 1990s that we never believed in—buckled under the two rough bear markets of the past decade. Institutions have fallen, too. Big ones. When Bill started his firm, Merrill Lynch; EF Hutton; Dean Witter; Shearson, Hammill & Co.; Kidder Peabody; and Bache were part of a long list of national brokerage houses. Does anyone remember Bateman Eichler, Goodbody, Hayden Stone, Mitchum Jones, or Bear Stearns? Nearly all are gone or transformed beyond recognition. You don't need that many years under your belt to know how hard it is to keep

the lights on in this business; this past decade saw many mergers, while other firms just disappeared.

So how is it that our firm, William O'Neil + Company, has survived for five decades with its portfolio intact and growing? How has our firm not only kept its lights on but expanded to cover global markets, with offices in Los Angeles, New York, Boston, and London? Because, since 1964, our time-tested methodology has guided us profitably in our portfolios and proven applicable to markets around the world.

I want to be clear: we do not think that we are smarter than anyone else in the business. But what we do better than most is *observe* the market's action and react according to a set of well-defined, historically proven rules. Those market rules—based on a half-century of studying the characteristics and behavior of rising and falling individual stocks and stock markets—encompass market directional analysis, stock picking, and portfolio management. For long-term success, you have to be good at all three—and not be satisfied with exceling at only one or two.

Many of our rules sound contrarian to investors who do not use stock charts and thus do not treat the market as the pure supply and demand mechanism that it is. For example, our research shows that many stocks will top while their quarterly earnings are still increasing. Therefore, you can't rely on fundamentals to determine when to sell. You must consult a chart and monitor the technicals, as a stock's breakdown in price usually precedes the breakdown of fundamentals.

Another cornerstone of our method is keeping losses to 7 to 8%. What would have happened if most investors had cut their losses at 7% in 2000–2001, as the market was imploding? Or, even better, if they had used some of our stock-selling rules that would have locked in gains during the first three months of 2000? A few years later, dark clouds were again gathering on the horizon, and I remember closing all of my long positions in November 2007—well ahead of the devastating 2008 break. In fact, all of our portfolio managers saw the mounting institutional selling (distribution) on the major indexes and quickly exited the market. We sat on the sidelines in cash as the S&P 500 fell more than 50%.

Operating in the stock market, for most people, is an exercise in extremes. When it's good—it's great—when it's bad—it's terrible. Our method helps keep us from getting caught up in the extremes that eventually may bring down individual investors and cause even the best institu-

tional investors to stumble. The first step of our method is to determine the overall trend using market directional analysis. This might sound simple to some investors—buy during an uptrend, don't buy during a downtrend—but correctly tracking the trend is the least understood aspect of investing. This became really apparent during the past decade, where a protracted choppy market got the better of most investors. In this kind of environment, uptrends are short and tend to end just as investors reach a comfort level with their positions. But when the charts give clear warning signs, our sell rules guide us to take the correct action when the market direction is starting to change. Sometimes it's not easy to put on the brakes and sell because of what the charts are indicating, but investors who don't act quickly enough usually experience a larger drawdown. Over time, especially in a back-and-forth market, their equity continually gets chipped away in a kind of death by a thousand cuts.

There is also a whole generation of investors out there who didn't find a need for learning to analyze the general market's direction. Some of these investors started trading during the booming 1990s and continued looking at post-2000 market action through a 1990s' lens. Many have given up. Those who started investing *after* March of 2000 actually have an advantage. They know how bad it can get. Knowing what you're up against in the market is essential to being successful long term. Most people don't realize that decades of success in the stock market is the exception, not the rule. They think it requires a strong offense, riding the big winners, fully loaded. Not true. Like a good sports franchise, long-term success requires that you build a dominating defense *and* a great offense.

Our defense is a robust set of sell rules that apply to circumstances in the general market and in individual stocks that often change without notice. Our approach may sound rigid, but historically determined rules, in fact, offer us the flexibility to wade in, build positions, back away, and go to the sidelines when necessary. This flexibility has kept us mainly on the right side of the market—especially at critical times of opportunity or real danger. I'm thinking of 1987, 2000, 2008, and all of the less drastic 20% drops in between.

Ultimately, capital preservation has been the number one rule this past decade. So many investors slipped backwards because they never made the mental shift from offense to defense. They continually focused on making money—not preserving it. They forgot that not going backward is a much

higher priority than trying to squeeze out a few extra percentage points. Remember, cash can be a position no matter how low the interest income.

Other investors have bought into the concept that their money always has to be working for them, even when they're asleep. That sounds good, but isn't always practical in the stock market. The buy and hold strategy comes to mind again here, an approach where you take your hands off the steering wheel and hope it all works out. And when it doesn't (and it *hasn't*), it takes some phenomenal gains to make up losses over time—no matter how low that price was when they started.

Our method also gives us a clear view of the stocks most likely to become the next new leaders. That's because our approach is based on a comprehensive analysis of every big winning stock since the late nineteenth century. Actually, picking the right stocks using our products isn't very hard at all. All of our products are designed to bring the best stocks to the surface in every cycle. That's not to say there's no art to picking stocks, but an investor can quickly narrow the field from thousands to a few dozen. We look for a company that is a leader in its space, with solid short-term and long-term earnings, plus a strong return on equity or high pretax profit margins. Bottom line, if the fundamentals aren't outstanding, we're not interested. Some of the stocks in which we invest may tend to have low brand-awareness. Usually they have gone public within the last 12 years. We tend to shy away from a stock that is too well-known or has become a market darling.

Most important to long-term success in the market is having the discipline to consistently follow a well-thought-out set of portfolio management rules. At William O'Neil + Company, we have time-tested rules that offer guidance on: how to enter positions while minimizing risk, when to be more aggressive, when to lighten up, and when to exit and sidestep bad markets. This last set of rules, which allows us to recognize the signs of a topping stock or a topping general market, is perhaps the most unique and powerful part of our method. Investors with a strong sell discipline are rare. Once a stock is purchased, many emotions will work against selling it—sometimes until it's too late. On top of this, the stock market has an uncanny way of exploiting human beings' character flaws and leveling all egos. When operating in the market, we want to remain balanced and humble, always learning from our mistakes.

The ability of our method to keep pace with the natural lifecycle of leading stocks—to identify them early, own them during a good part of their run, and sell them when the move is likely over (often when a new innovation or

breakthrough outmodes them)—is what keeps our approach ever current. The chart patterns stay the same, only the names fade away, with new ones continuously taking their place. That is the nature of the U.S. stock market. Stock market cycles and American business have always been driven by entrepreneurs and their brilliant innovations. Entrepreneurs are the real drivers of capitalism and job creation. As long as entrepreneurs exist and are supported in their pursuit, we should participate in their success for the next 50 years and beyond. Remember, there will be many big opportunities in the future, but you have to do your homework and stay on top of the job to fully capitalize on these opportunities. Never give up.

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Chris Gessel

Chris Gessel is executive editor and chief strategy officer for *Investor's Business Daily*. He is keenly focused on content to help investors. I talked with Chris about some of his approaches to investing. I also wanted to share with you a sense of our “behind the scenes” work.

Amy: Chris, over the years what have you found are the most important things for an investor to do in order to succeed?

Chris: Many investors want to make money in the market *all* the time. They find it nearly impossible to step back from the market when it's in a downtrend. Yet, the worst time to be buying stocks is when the general market is in a correction. If investors continue to buy stocks during a downtrend and lose money, they eventually give up and walk away from the market.

The secret is to stay engaged in *every* market, but especially while it is correcting. Yet many people, even if they aren't losing money, become demoralized and pessimistic. I know the feeling. After weeks, months or

sometimes even a year of a declining stock market, it's hard to stay focused and positive. What's fun about watching stocks grind lower day after day?

Over the years I've talked with too many investors who turn away entirely from the market during corrections. The irony is that market corrections are *when the big leaders of the next cycle are shaping up*. These companies are reporting strong earnings and innovations that can't overcome the general market weakness. But they are often the first stocks out of the gate when the market turns back up.

Amy: You don't want to miss those. Many of us have made our biggest gains after staying tuned in during corrections and finding the real leaders.

Chris: Right—and three to six months into a new bull market, those discouraged investors notice that stocks have really taken off. But now they're late to the party and find that most leaders have already broken out and made big gains.

So stay in phase with the market. When the stock market follows through after a correction, you want to be there and take advantage of all the great opportunities that present themselves. Even in a modest rally, you can make a lot of money by following the market rules and staying on top of the current leadership.

Amy: Great advice that a lot of us live by. Once someone understands the rules of the overall market, what is the next biggest challenge for investors?

Chris: Portfolio management is absolutely essential. Once you understand the basics of CAN SLIM stock selection and investing, you need to master very specific buy, hold and sell rules.

Justin Nielsen, David Chung, and I teach the IBD Level 3 Workshop, which focuses on advanced investment strategies. The primary element of the seminar is a trading simulation where investors get to walk through buying and selling scenarios with us from a real market cycle. You learn to spot the right time to invest; find top stocks, and see how wise it is to take many 20 to 25% profits so you're making money along the way. Not every stock will turn into a super winner, but many leading stocks in an uptrend will deliver solid 20% profits. If you get into the habit of selling and locking in those gains you'll see real progress in your portfolio.

Amy: How do you know when you've found a big winner?

Chris: One very important rule to follow is the 8-week holding rule. When a stock breaks out and runs up more than 20% in less than 3 weeks, you need to hold that stock for a full 8 weeks before you make a longer-term decision. The power of the rule is that it helps you sit through short-term shakeouts and go for much larger gains.

The majority of stocks, however, won't trigger that rule; they may go up 25% in 5 or 6 weeks. If you take your profits at that point, you'll have banked real money and then you can reinvest it in a new breakout. And the stock that you just sold in many cases will build another base over the following weeks or months and then give you another opportunity. You're compounding your profits. The reason this works so well is the fact that many growth stocks typically run up 20 to 25% and then consolidate and form another base.

Amy: Where can you find these stocks in IBD?

Chris: *Investor's Business Daily* is loaded with new stock ideas every day. There are two features every investor should monitor all the time. The first is the *IBD 50*, which is published Mondays and Wednesdays. We screen for the best stocks with strong fundamentals and excellent price performance. There's a mini chart with each stock along with a description of its base pattern, and whether it is near a buy point. These quick descriptions are how many investors hone their chart reading skills.

Another great way to find stocks is to review the names at the top of each sector in the Research Tables. These Sector Leaders come from our most demanding screen and are the result of years of research into what makes a top-tier leading stock. Very few stocks can meet all the criteria to become a Sector Leader, so those that make this list should definitely be on everyone's watch list. Analyze their chart patterns and read as many archived stories as you can. Most of the biggest leaders stay on the Sector Leader list during prolonged market uptrends.

Amy: Can a newer investor or someone who is short on time succeed with these features?

Chris: Doing exceptionally well in any field takes some work, but IBD has a lot of resources to make it easier for investors. We have hundreds of Meetup Groups across the country where IBD readers gather each month to share ideas, use our market courses created for these groups, and help each other understand how the stock market works. We also introduced a new service in 2011 called Leaderboard. I think of Leaderboard as real-

time education that also does a lot of the legwork for you. In Leaderboard, the market team scours all of IBD's best lists to find stocks that meet most if not all the CAN SLIM criteria. Then we mark up the charts to find the bases, the buy points, when to hold and when to sell.

What is gratifying is that we see people who are brand new to the stock market succeeding, as well as seasoned money managers who take the service for a second opinion of what they are seeing in the market.

I've seen roaring bull markets, punishing bear markets and everything in between since I've been at IBD. But what is amazing is that every time we start a new uptrend, the vast majority of big winners show up in IBD's stock screens and stories. The opportunity is there for everyone to succeed in the stock market.

Matthew Galgani

Matthew Galgani is co-host of *IBD's How to Make Money in Stocks* radio show, editor of the *IBDextra! Newsletter* and host of the Daily Stock Analysis video at Investors.com.

Amy: Matt, while I was writing my book *How to Make Money in Stocks Success Stories*, you were working on a complementary book called *How to Make Money in Stocks: Getting Started*.

Matt: It's inspiring when you read the stories in your book. It got me pumped up. These people literally changed their lives simply by learning how to invest. So I think the next question folks will have is, "How can I do that too—and how do I get started?" They may also wonder: "Can I really do this? Do I have the time? Can I learn what these people learned?" That's where my book comes in. Using simple, step-by-step checklists, I walk you through the three basic things you need to know—what to buy, when to buy, and when to sell.

And let's be honest. People come to investing with the *hope* that they'll make lots of money, and the *fear* that they'll lose their shirt. I know I did. But I'll show you how to set realistic expectations that are absolutely achievable, and I'll also give you two simple rules that will make sure you never suffer a big loss. So if you're ready to jump in but are a little nervous (and, by the way, that's completely natural and healthy), the buying and selling checklists in my book will get you started in a safe and sensible way.

Amy: You also worked closely with IBD Chairman and Founder Bill O'Neil on the 13-part IBD *Meetup Investor Education Series*, which is available exclusively to IBD Meetup members. Can you tell us about those lessons?

Matt: In retrospect, I think the *Getting Started* book was inspired by that experience. Our goal was to create easy-to-follow lessons that would walk Meetup members through the must-know concepts of investing. Bottom line is, we wanted to make sure people understood how to both grow and protect their money. So lessons cover all the key things: When to get into and out of the market, what telltale traits to look for in a winning stock, and how to use charts to give you an extra edge by pinpointing the best time to buy and sell.

After I finished each lesson, Bill and I would go through it slide by slide, word by word. Sometimes I felt like I was working with Steve Jobs to design an Apple product—we kept cutting and cutting, until we got the lesson down to its most simple and tightly-focused form.

One thing really hit home as we were doing this: Investing is a skill best learned in stages. You can't dump *everything* on someone all at once and expect them to understand it, let alone use it effectively. So we broke the lessons up into bite-size chunks that people could wrap their heads around. When one stepping stone was in place, then we moved on to the next.

The *Getting Started* book takes a similar approach. Step by step, you'll learn what to look for in a stock before you buy. Then, you'll see how to determine the best time to buy that stock. And then you'll learn a specific selling game plan to decide when to lock in your gains or nip any losses in the bud.

I'm a very hands-on learner. I can't just read—I have to jump in and start doing it. That's just how things sink in for me. So both the IBD

Meetup lessons and the *Getting Started* book reflect that. At the end of every chapter, I have “action steps” that give you specific, easy-to-do tasks that reinforce what you just read. It could be watching a *2-Minute Tip* video on the same subject, or using certain tools to put together a watch list of top-rated stocks. Whatever it is, it gives you that hands-on experience you need to start putting the rules and checklists into action in the real world.

So, Amy, I guess the bottom line is this: Now that folks have been inspired by the remarkable stories in your book, the next step is to start creating their *own* success stories. I realize I’m a little biased here, but I know from my own personal experience that what you learn in *How to Make Money in Stocks: Getting Started* can help anyone create lifelong, financial peace of mind.

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IBD Workshops

I sat down with some of IBD's education experts and talked about the workshops that are offered throughout the United States.

Ralph Perrini is a National Speaker for IBD and Vice President of Sales. Jonathan Howard is Vice President of Education and in charge of IBD's paid workshops. Justin Nielsen is a National Speaker and works on special projects with Bill O'Neil. All three travel throughout the U.S. teaching the CAN SLIM Investing System.

Amy: Describe IBD's workshops and why the different levels were created.

Ralph: The biggest impediment that most investors face is a lack of understanding how the market works. That's why we've constructed four core workshops. The Level 1 workshop helps investors new to the CAN SLIM System learn how to interpret the market, buy stocks at the right time and sell to protect profits. It's primarily for investors who are new to CAN SLIM Investing. Our first goal was to dispel a lot of myths about investing such as buy low, sell high, or buying stocks with a low P/E. Our primary theme in

the workshop is to help investors buy stocks with great fundamentals coming out of a sound base pattern. We teach investors to buy on strength with a stock that has already proven itself. We help investors learn a fact based system founded on decades of research gleaned from studies of the best performing stocks from the 1880s to the present day.

Justin: The Level 2 workshop which I teach with Scott O'Neil shows investors how to spot market tops and bottoms, how to read charts more accurately and profitably, and screening techniques to identify emerging winners.

Jonathan: The Level 3 workshop was designed to teach investors what to do between the initial buy and the final sell. We teach advanced holding and selling strategies, the intricacies of portfolio management, and the importance of post analysis. Finally, the speakers will put all the pieces together in a unique trading simulation, applying the CAN SLIM System in a real-market environment.

Ralph: And the Masters Program or the Level 4 features Bill O'Neil, IBD's founder, and includes sessions with O'Neil Data Systems portfolio managers. We bring together the best financial minds to provide two days of intense, comprehensive training that can turn attendees into successful investors for the rest of their lives.

Justin: In addition to those workshops, we have three other workshops that are subject-specific such as Chart School, Marketschool, and the Model Stock Summit.

Jonathan: All of the workshops are designed to help investors reach a higher level of investing. However, we realized that some people, due to job commitments or travel considerations, can't attend some of the workshops, so many of these great learning moments are available in the Home Study Courses.

Ralph: We started this series of workshops in 2004 and have been able to help countless investors who have taken the courses.

Amy: Why do you think so many people have had success after attending these workshops?

Justin: The vast majority of the investing public doesn't follow an investing system. They purchase stocks solely based on gut feelings or poor advice

and that is where we're unique at IBD because we get into the facts behind why stocks move up and why they eventually falter and turn down. Investors walk away with a clear understanding of what to look for in potential leaders.

Jonathan: Through the years, we've heard horror stories of people losing much of their life savings because they don't have a system that they follow, or they've received poor professional advice. The aim of our workshop series is to give investors a proven system with sound rules that will provide the tools necessary to make money when the market is in an uptrend, and more importantly, protect their capital in a downtrend. We want our investors to leave the workshops feeling confident and prepared to handle whatever the market throws at them.

Ralph: Another impediment to investing are emotions, most people invest from an emotional point of view. When they take a position in a stock and it begins to go down in value, they typically rationalize why it will come back. So at IBD's workshops, we give you some specific rules that will help take the emotions out of it. We've found in our many years of teaching workshops that thousands and thousands of investors now feel much more secure with their finances and with their retirement because we've had a dramatic impact in helping them improve their investing returns.

• KEY THINGS TO REMEMBER •**Market Direction Is Everything**

- Invest when the market is in a confirmed uptrend. Most stocks follow the overall market trend so it's important to invest when the market and leading stocks are moving higher.

Preservation of Capital Is the Most Important Part of Investing

- Always sell a stock if it falls 7 to 8% below what you paid for it. Keep your losses small and let your winners run.

Success Is Definitely Attainable If You Stick to the CAN SLIM Investing System

- It's necessary to have a set of rules. If you follow CAN SLIM, gains of 20 to 25% and more are very possible during a bull market. You can and will outperform the major moving averages.
- The successful investors that you've read about in this book achieved their stock market gains by staying true to the CAN SLIM System. Don't add other methodologies or techniques. You will find this lowers your odds of success.

Helpful Information

Understanding the Trend

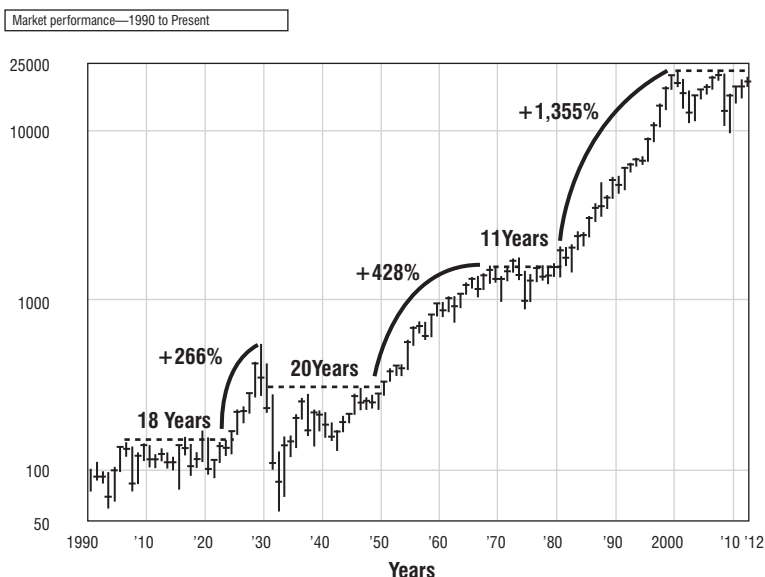
Secular Bull and Bear Markets

Secular bear markets can last 12 to 18 years in length where the major indexes don't make significant price progress and can suffer sharp overall price drops over portions of the period. They are followed by secular bull markets that can last from 20 to 30 years. Since 1900, the indexes have gained from 200% to 1355% during these secular bull market periods.

Cyclical Bull and Bear Market Cycles

There are cyclical bull and bear market cycles within the overall secular trend. A cyclical bull market lasts on average from 2 to 4 years. A cyclical bear market lasts from 3 to 9 months and in rare cases as much as three years.

IBD has studied the 27 bull and bear market cycles going back to 1880.

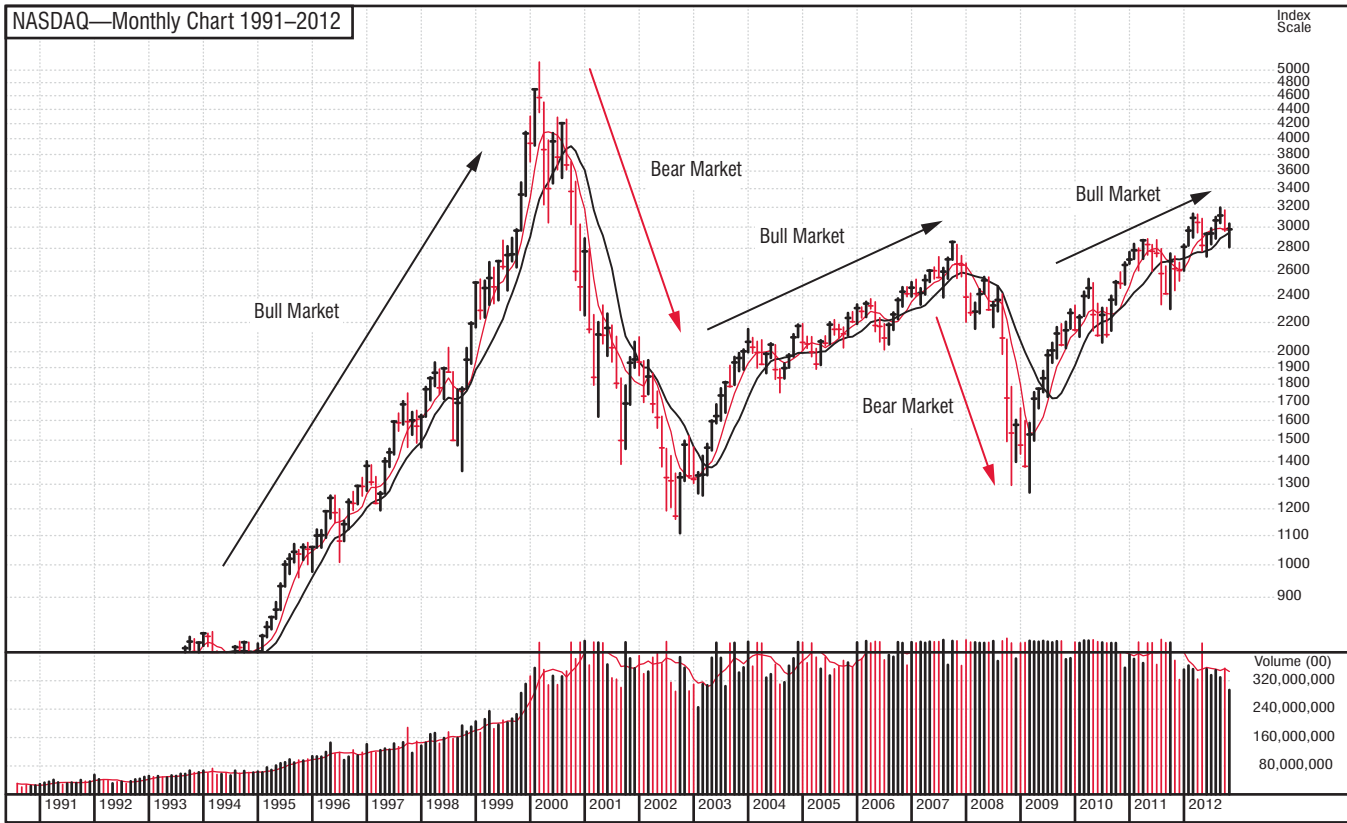


Uptrends and Corrections Within Cyclical Bull and Bear Market Cycles

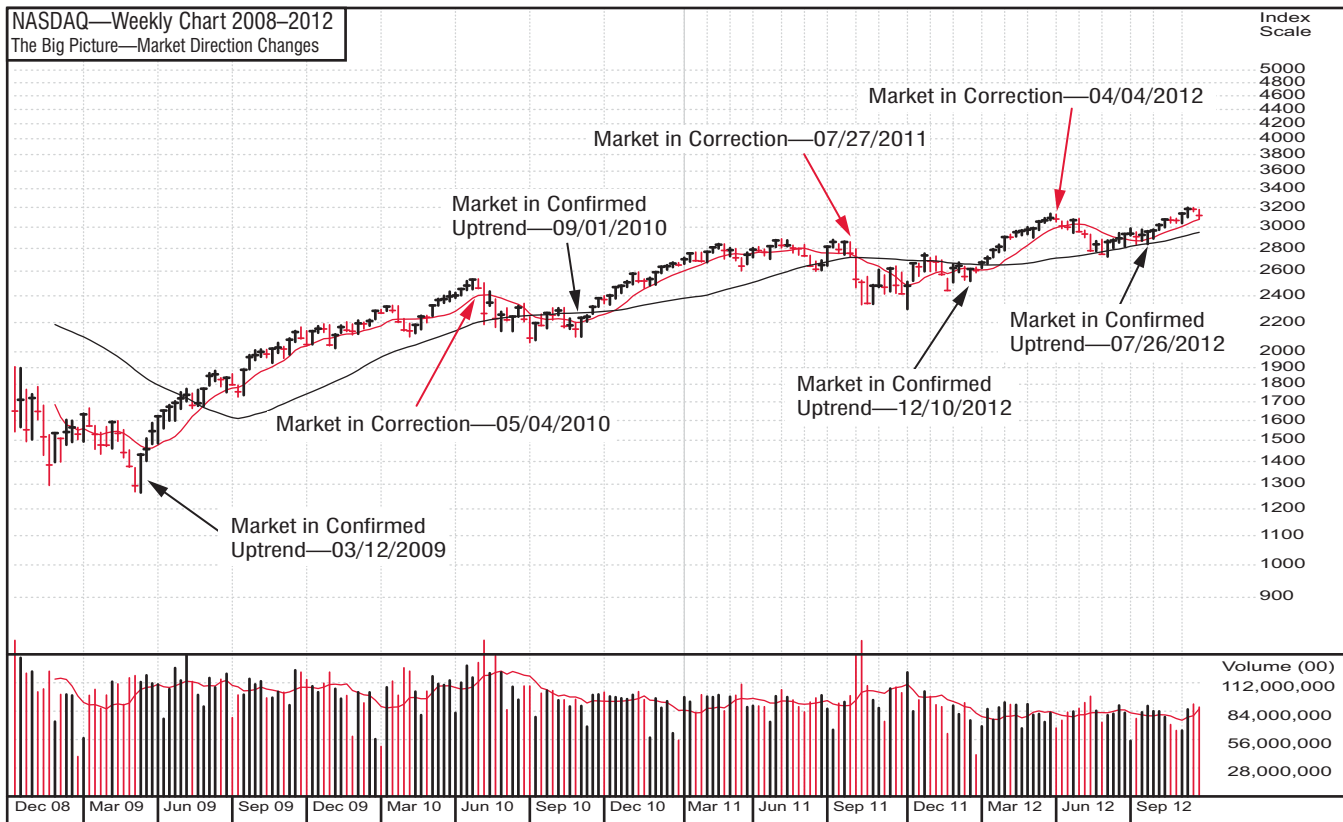
Within the cyclical bull and bear market cycles there are tradable rallies or uptrends and there are periods of time when the market pulls back and corrects.

• FOLLOW THE TREND •

- Read *The Big Picture* column in IBD daily.
- Watch the *Market Wrap* video at Investors.com/IBDTV.



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Amy's Suggested 20-Minute Daily Routine

To Determine the Market's Current Trend:

1. Read the *Market Pulse* in the IBD's *Big Picture* column. Is the market in an uptrend or downtrend?
2. Watch the *Market Wrap* Video at Investors.com/IBDTV to learn more about the market's daily action and to stay on top of leading stocks.

To Find Leading Stocks:

1. Follow the stocks in the *IBD 50* (published Monday and Wednesday). Keep a watch list of stocks nearing a potential buy point. (Read the short sentence under each chart to help identify the proper buy point.)
2. Check *Stocks on the Move* at Investors.com for stocks rising on heavy volume, indicating institutional buying.
3. Read *The New America* article to learn about innovative companies with exciting new products or services.
4. Find out more about a stock's fundamentals with *Stock Checkup* at Investors.com.

Amy's 1-Hour Weekend Routine

1. As you're going through *IBD 50*, jot down names of companies that you're not familiar with. Read articles and learn more about what the company does at Investors.com. Articles can be accessed by entering the ticker symbol in the "enter symbol, keyword" section and then clicking on "search site."
2. Watch the *Daily Stock Analysis* videos at Investors.com/IBDTV to learn more about chart reading.
3. Update your watch list:
 - Have a ready list, stocks that are nearing a potential buy point that you have researched and are prepared to buy if they break out on volume that is at least 40% above average.

- Consider entering trade triggers through your brokerage service so a stock could be bought or sold even if you are busy.
 - Keep another list of stocks that aren't close to a breakout but that are building a base or consolidating gains, particularly if the stock has already proven itself to be a market leader.
4. Read sections of *How to Make Money in Stocks* for continuing education and to help understand the CAN SLIM Investing System better.

Extended Daily Routine

Add these steps to the daily routine above:

1. Check the mini charts in *Stock Spotlight*. This list materially outperforms the S&P 500, so any new names that appear on the list may be well worth researching further.
2. Learn more about Sector Leaders in the *Research Table Review* and find out how they are performing in the current market. These sector leaders are stocks with the best fundamentals, such as outstanding earnings, sales, and a high ROE (return on equity).
3. Read the *Industry Themes* article to keep up with leading trends among industry groups or to see if there is a shift from one leading industry group to another one.
4. IBD's *New High List* shows stocks that have reached new 52-week highs. IBD research shows that stocks making new highs tend to go higher. The *New High List* Analysis describes more about the companies that are making new highs and have top fundamentals.
5. Read and study the historical charts from William J. O'Neil's article, *How to Find and Own America's Greatest Opportunities* in the Wednesday edition.

For continuing education read articles in *Investor's Corner*.

Extended Weekend Routine

Add these steps to the weekend routine above:

1. Check *Your Weekly Review* (found in the Friday edition) mini charts for stocks approaching a potential buy point. Research more about the company with articles found at Investors.com.
2. Study chart patterns of stocks setting up by using Investors.com charts or by using MarketSmith charts, a premium charting service and IBD sister company.
3. Listen to IBD's *How to Make Money in Stocks* radio show at Investors.com/radioshow.
4. Study the 100 charts that are in the front of *How to Make Money in Stocks* to learn more about base patterns and life cycles of the big market winners.
5. Write in a journal your trades for the week or thoughts about the general market. This will help as you do a year-end post analysis.

CAN SLIM Investing System

C = Current Quarterly Earnings of at Least 25%

Where to find earnings in IBD:

- *Stock Spotlight* charts
- *IBD 50* charts (Monday and Wednesday editions)
- *Big Cap 20* charts (Tuesday)
- *Your Weekly Review* (Friday)

A = Annual Earnings Growth of at Least 25% over the Past 3 to 5 Years

Return on equity (ROE) of at least 17%. Where to find annual earnings in IBD:

- *Stock Spotlight* charts
- *IBD 50* charts (Monday, Wednesday)

- *Big Cap 20* charts (Tuesday)
- *Your Weekly Review* charts (Friday)

N = New Companies with New Products, New Services, New Price Highs

Where to find in IBD:

- *The New America* (daily)
- *IBD 50* (Monday, Wednesday)
- *Internet & Technology* (daily)
- *IBD New High List* (daily)

S = Supply and Demand

Huge increases in volume compared to the daily average = demand. Where to find in IBD:

- Volume % change
- Accumulation/Distribution Rating
- *Stocks On The Move* (print edition, *eIBD* and *Investors.com*)

L = Leader vs. Laggard

Look for the top stocks both fundamentally and technically in the very best-performing sectors and industry groups. Where to find in IBD:

- *IBD Stock Checkup* (*Investors.com*)
- *IBD 50*
- *Your Weekly Review*
- *52 Week Highs & Lows*

I = Institutional Sponsorship

The big money. The smart money. Where to find in IBD:

- Accumulation/Distribution Rating
- Volume % change
- *Stocks on the Move* (*Investors.com*)

M = Market Direction

Is the general market currently in a confirmed uptrend or downtrend?
Where to find in IBD:

- *The Big Picture*
- *Market Wrap Video* (IBD TV, Investors.com)

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INTRODUCTION BY **WILLIAM J. O'NEIL**,
FOUNDER OF *INVESTOR'S BUSINESS DAILY*®

How to Make Money in Stocks Getting Started

***A GUIDE TO PUTTING CAN SLIM®
CONCEPTS INTO ACTION***

MATTHEW GALGANI

Co-Host of *How to Make Money in Stocks* Radio Show

How to Make Money in Stocks

Getting Started

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CONCEPTS INTO ACTION***

MATTHEW GALGANI



New York Chicago San Francisco
Lisbon London Madrid Mexico City Milan
New Delhi San Juan Seoul Singapore
Sydney Toronto

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• FOREWORD •

How to Make Money in Stocks—Getting Started is an important book for all investors.

If you're new to the stock market and unsure—perhaps nervous—about how to begin investing, Matt's book may be the missing link you've been looking for. You'll find a step-by-step game plan with checklists and routines to make sure you start out right. More experienced investors can reference these same strategies and tools to streamline their routines and further improve their returns.

From the time I founded Investor's Business Daily in 1984, we've focused on education, knowing that anyone with a desire to learn can become a successful investor. Since then, countless people from all walks of life have used IBD® and the CAN SLIM® Investment System to achieve significant results.

I first met Matthew Galgani a decade ago when he came to us to help market IBD to more investors. He also had a strong desire to master the CAN SLIM System to build his own financial future. Matt began attending dozens of IBD workshops around the country, then went on to help establish and expand the IBD Meetup® program in its early stages.

Since then, he has been involved in several pivotal educational products, including co-hosting IBD's weekly radio show, editing the *IBD®extra* Newsletter, and creating *IBD TV®* videos. Matt also helped me develop the *IBD Meetup Investor Education Series*, a 13-part course created specifically for Meetup members. Each month, those interactive lessons are used by local groups all over the nation and are one of the best ways we've found to help investors establish a clear plan for making money in the market.

Getting Started is a natural complement to my earlier work, *How to Make Money in Stocks*. Matt's book helps you take those crucial first steps while creating proper investing habits that help you build wealth over time. No one becomes a successful investor overnight. Like all skills, investing takes time and effort to learn. But anyone with patience and perseverance can do it. The key is to follow a sound plan and never give up.

I've read this book carefully and can tell you that in the pages ahead, you'll discover an investing plan that works. The rest is up to you. I have no doubt that if you study and stick to the rules outlined in *Getting Started*, you can benefit greatly.

Understand that you do not need to do this on your own. IBD is here to help you every step of the way with free educational resources, including the IBD Meetup program, product training, *IBD TV* videos, and more. If you ever have any questions, call our toll-free educational hotline (800-831-2525) to get the help you need.

We're wishing you the very best in your investing journey.

Sincerely,

A handwritten signature in black ink, reading "Wm J. O'Neil". The signature is fluid and cursive, with the first name "Wm" and last name "O'Neil" clearly visible.

William J. O'Neil
Chairman and Founder
Investor's Business Daily

• INTRODUCTION •

What's the Difference Between <i>Getting Started</i> and Bill O'Neil's <i>How to Make Money in Stocks</i> ?	xiii
What You'll Learn in <i>Getting Started</i>	xiii
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This is a book about taking action. About taking specific steps to get started on *your* path to making more money in the stock market.

Let me start with a little story about my own journey...

Before I began investing in the mid-1990s, I read several books about the market. They were definitely helpful in terms of deciding what to buy.

It wasn't until later I realized something was missing.

They didn't address the other—equally important—pieces of the puzzle: *When to buy* and *when to sell*.

But at the time, I was making money. And when you're making money, who needs sell rules?!

The rise of personal computers, the Internet and cell phones had launched an explosive bull market, and I was making 35% one year, 40% another. Like millions of other investors, my “strategy” was basically to buy and just hold on for the glorious ride.

But in reality, I was blissfully unaware of my own ignorance.

I didn't know that in a bull market, the vast majority of *all* stocks go up. So while I may have *thought* my gains were due to my newfound investing genius, I was actually just getting lucky. It was pure coincidence that I happened to buy at the right time. In fact, I had no idea there even was a “right” and “wrong” time to invest.

And that led to my next rather painful epiphany: I had no sell rules. When the dot-com bubble burst in 2000, I had no clue what to do because I didn't understand how market cycles work. I didn't realize my primary goal should

be to make money when the market is up and protect those profits when the market heads south. So I just sat there and watched a frustratingly large portion of my gains disappear.

A Better Way

It was after that episode that I joined Investor's Business Daily (IBD) and discovered I did *not* have to be at the mercy of the market:

- I *could* see the right—and wrong—time to invest.
- I *could* have a game plan for locking in profits.
- I *could* use simple sell rules to avoid any serious losses.

That was a game-changing epiphany for me—one that has proved invaluable in the decade since. Now, whether I'm making *Daily Stock Analysis* and *2-Minute Tip* videos, editing the *IBD®extra* Newsletter, or co-hosting IBD's weekly radio show with Amy Smith, that crucial revelation is never far from my mind.

So when I got the opportunity to write this book, I started with a simple question: What kind of book do I wish I had when *I* was starting out?

It quickly boiled down to 3 things:

1. **Keep it simple:** Focus on the basics so even new investors can see how to get started while staying profitable and protected.
2. **Make it interactive and actionable:** Include hands-on action steps and videos that make the key points sink in, helping you quickly put what you learn into action.
3. **Use easy-to-follow routines and checklists:** Lay out a *specific* step-by-step game plan anyone can use to make—and keep—solid gains.

Having the checklists and Action Steps you'll find in this book would have helped me *tremendously* when I was starting out. And if you stick to these time-tested rules as *you* get started, you'll be following a proven roadmap for growing—and protecting—*your* money.

History, Not Hunches

As you'll see, everything IBD does is based on a simple concept: To find tomorrow's winning stocks, you need to understand what past winners looked

like just *before* they made their big gains. And you need to know what sell signals they flashed as they eventually topped and began to decline.

In other words, if you want to significantly improve your investing results, start by studying the best stocks—and the best investors.

One legendary investor you definitely should learn from—and one I've been very fortunate to work with for a decade—is William J. O'Neil, chairman and founder of Investor's Business Daily.

And that leads us to a question you may be asking . . .

What's the Difference Between *Getting Started* and Bill O'Neil's *How to Make Money in Stocks*?

Bill's classic book, which has sold well over 2 million copies, is the definitive explanation of the CAN SLIM® Investment System he developed many decades ago.

If you haven't already, **I *strongly* encourage you to read Bill's book.**

It provides invaluable insight into over 130 years of market history, a detailed look at what big winning stocks look like before—and after—they make a big run, and a clear set of buy and sell rules to guide you.

This book, *How to Make Money in Stocks—Getting Started*, is meant to supplement, not replace, Bill's classic work.

Think of it this way: Bill's book gives you the grand strategy. *Getting Started* shows you how to begin *applying* the basics of that strategy right now.

Investing is a skill. And like any skill, it's best learned in stages. But where do you begin?

That's where *Getting Started* comes in. Together, we'll go through specific steps you can take right now to improve how you pick stocks and, just as importantly, how you handle them *after* you buy.

Whether you're a new or experienced investor, the routines and checklists we'll go over provide a solid foundation for making substantial profits. With that foundation in place, you'll be able to invest with confidence from the start and add to your skills over time.

What You'll Learn in *Getting Started*

Again, this book is about taking action. You'll find a **Simple Weekend Routine** that helps you zero in on today's top stocks and **Buying and Selling Checklists** that show you the right time to get into—and out of—the market.

Plus, by taking the **Action Steps** you'll find throughout the book, you'll get the hands-on experience you need to apply these rules in the real world. If you follow these steps and stick to the checklists, you will see a *major* difference in your ability to buy and sell stocks profitably.

After reading the book and practicing the Action Steps, you'll know how to:

- Protect your money
- Quickly identify stocks with the greatest potential
- Use simple routines and checklists to buy—and sell—those stocks at the right time

How to Get the Most Out of This Book

A few years ago, I spent several months working with Bill O'Neil to create the *IBD Meetup Investor Education Series*, a 13-part course designed specifically for members of the free IBD Meetup program, a nationwide network of local investing groups.

That course was made to be highly interactive: Each IBD Meetup group can go through a lesson at their monthly get-together, then members can apply what they learned on their own at home.

This book is also meant to be highly interactive. As an old IBD slogan used to say, "Don't just read it. Use it!"

Nothing would make me happier than to see your copy of *Getting Started* marked up with highlighters and notes and dog-eared with coffee stains. (You should see my copies of *How to Make Money in Stocks*.)

Don't Try to Do It All in One Go!

I suggest you take this book in bite-sized pieces.

First, check out Chapter 1, "Start Here." That'll give you a "big picture" look at the basic game plan for making money in the market.

Then go through the subsequent chapters one at a time . . . take the Action Steps . . . then take a little time to digest and practice what you've learned using the simple routines (Chapter 4).

In other words, don't force it. You're not going to read and remember all this in one sitting! Take it step by step, and you'll start to see how all the pieces fit together. Then the light bulb will turn on, and you'll be ready to start right—and begin making money in stocks.

Start Right with 3 Must-Do Steps

To see how to check each of these items off your “To Do” list, visit www.investors.com/GettingStartedBook.

1. Get Started with Action Steps

Be sure to do the Action Steps you’ll find throughout the book.

Everyone learns differently, but I like to *do* as I learn. So I suggest you complete the Action Steps in one chapter before moving on. It’ll help the concepts sink in faster.

See How to Apply the Strategy with Free Videos

On the web page we created specifically for this book, you’ll find several videos that give you an “in-action” look at the key rules and routines we’ll cover in the pages ahead. Be sure to watch them! It’s an easy way to enhance and expand on what you learn in the book.

You’ll find some overlap in the Action Steps from chapter to chapter. That’s intentional. As legendary UCLA basketball coach John Wooden said, “Repetition is the key to learning.” Going through each step in each chapter will help you start investing *correctly* right out of the gate.

2. Activate Your Free Trial of IBD

Because this book is about *applying* the strategy you’ll learn, many Action Steps are based on seeing what’s going on in the market *right now*:

- What stocks are in today’s *IBD 50* or *Stock Spotlight*?
- Is now a time to buy stocks—or take defensive action?
- Do the stocks you’re looking at get pass—or fail—ratings in *Stock Checkup*®?

If you don’t already have a subscription to IBD, you’ll need to activate your trial to access some of the tools and features as you go through the Action Steps.

3. Take Advantage of IBD’s Free Investor Training

We can all use some help when learning a new skill, and investing is no different. So don’t think you need to go it alone. Here are two *free* ways you can jump-start the process and get answers to any investing questions you may have.

Join Your Local IBD Meetup Group

I used to run the IBD Meetup program, so I can tell you from personal experience it's a great way to put into action all the rules and concepts you'll learn in this book.

We have over 250 local groups all around the country (and overseas) where people just like you get together monthly to discuss the market, build a watch list, and help improve each other's skills.

We actively support these independently-run groups with the *IBD Meetup Investor Education Series* I developed with Bill O'Neil, and by sending IBD speakers to give free workshops.

Visit the website below to find the group near you.

Sign Up for a Free IBD Training Session

In these phone or online sessions, an IBD trainer will show you how to use IBD and Investors.com to apply the investing strategy we'll cover in this book. On your computer, you can follow along as the trainer walks you through the tools and features—and feel free to jump in anytime with whatever questions you may have.

You can see how to take the Action Steps, start your free trial, sign up for a free training session, and find your local IBD Meetup group at: www.investors.com/GettingStartedBook.

Now let's jump right in.

Let Me Know How You're Doing!

I'm always curious to hear from investors, so I hope you'll let me know how *your* getting started process is coming along. You can send me any questions and feedback at GettingStartedBook@investors.com.

I look forward to hearing from you—and wish you much investing success!

How to Make Money in Stocks

Getting Started

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1

• CHAPTER •

Start Here

Before we get into the details in later chapters, I want to make sure you see the primary goals—the big picture—here.

So let's start with a quick look at the investing *forest*, then we'll start examining the *trees*.

If you ever start to feel a little overwhelmed as we go through the checklists and charts later in the book, take a breather and come back here. You may even want to put in a bookmark or dog-ear this page as a reminder.

That will help you stay grounded and focused on what matters most: Using basic rules and routines to both grow—and protect—your money.

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How to Protect Your Money

Talking about how to *protect* your money—how to *avoid big losses*—is not the most exciting way to kick off a discussion about building wealth. But it's absolutely critical.

Job #1 in making money in stocks is to protect the money you already have.

And you can do that just by following two basic rules. They will protect you even when—in fact, *especially* when—the market becomes volatile and slips into a downtrend.

When we go through the **Selling Checklist** later in the book, you'll see several common signals that tell you it's time to lock in your gains or cut any losses. Over time, you'll become better and better at spotting those signs, but for now—at a minimum—be sure to stick to these two rules. They'll help you safeguard your money as you learn new ways to grow it.

1. If a Stock Drops 7% to 8% Below What You Paid for It, Sell. No Questions Asked.

This one simple rule puts a cap on potential losses—like having insurance to protect you against whatever the market does. Simple and sensible.

You'll find it's much easier to grow your money if you follow this rule. Instead of trying to make up for larger *losses*, you'll be adding to and compounding your *gains*.

I can't emphasize enough how important this rule is.

Every investor—including legendary traders like Bill O'Neil—makes mistakes. But *successful* investors quickly acknowledge those mistakes—and cut their losses short. Always. You should do the same, and you can do it by following this one simple rule.

*See the **Selling Checklist** section for more on this rule—and how I learned it the hard way.*

2. Only Buy Stocks When the Overall Market Is in a “Confirmed Uptrend”

IBD’s study of every market cycle since 1880 shows 3 out of 4 stocks move in the same direction as the overall market, either up or down.

The “overall” or “general” market refers to the major indexes, primarily the Nasdaq Composite, S&P 500, and Dow Jones Industrial Average.

When the market is trending down, about 75% of all stocks will eventually decline with it.

Does that sound like a good time to *buy* stocks? To keep the odds in your favor and make it *much* easier to grow your money, be sure to only make new purchases when the market is in an uptrend.

As you’ll see in the next section, “The Basic Game Plan for Making Money in Stocks,” you’ll know if the market is in an uptrend or downtrend simply by checking the *Market Pulse* inside IBD’s *The Big Picture* column.

Only make new buys when the current outlook is “Confirmed uptrend.”



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See the **Buying Checklist** section for more on this key rule and how to apply it.

Protect and Prosper

Most people start out focusing on what stocks to *buy* and ignore the other absolutely critical part of the puzzle—when to *sell*.

All too often, a new investor won’t realize he or she needs some sell rules until *after* suffering a large loss. Don’t let that happen to you!

Start off right by sticking to these two basic rules. They’ll help protect your money as you learn to pick winning stocks and prosper.

The Basic Game Plan for Making Money in Stocks

We'll go through the CAN SLIM® Investment System in the next chapter, but for now just understand that by using this approach, you can:

- **See when the market trend is changing** so you'll always know if it's time to buy stocks or take defensive action.
- **Identify stocks with the most potential** by looking for 7 traits the biggest winners typically display just *before* they launch a major price move.

Then, using the routines and checklists in this book, you'll see the specific steps you can take to make money in:

- Individual stocks
- Exchange-traded funds (ETFs) that cover the Nasdaq and S&P 500
- Or a mix of both stocks and ETFs

The focus of this book is on individual stocks. The biggest winners in a strong bull market can go up 100%, 300%, even 1,000% or more. In the bull cycle that started in March 2009, Apple, Priceline, Lululemon Athletica, Ulta Beauty, Green Mountain Coffee Roasters, Chipotle Mexican Grill, Rackspace Hosting, 3D Systems, Michael Kors, and many others did just that. In other words, the huge, life-changing gains are made by zeroing in on the true market leaders—and you'll see how to do that using the Simple Weekend Routine and Buying Checklist.

That said, you *can* generate solid gains following the ETF approach we'll go over in a minute, and it takes less time.

Should You Invest in Stocks, ETFs, or Both?

The choice is up to you. There is no right or wrong answer, and you can always do both: Put a certain percentage of your money into individual stocks and another portion into an index-based ETF.

Many CAN SLIM investors follow a mixed approach, and I think it's an excellent way—especially for new investors—to get started.

Basic Game Plan for Making Money in Exchange-Traded Funds (ETFs)

As we'll see again and again throughout this book, staying in sync with the general market trend is the first crucial step to making money—whether you're trading stocks or ETFs. The reason for that will become crystal clear in a minute.

What is an Exchange-Traded Fund?

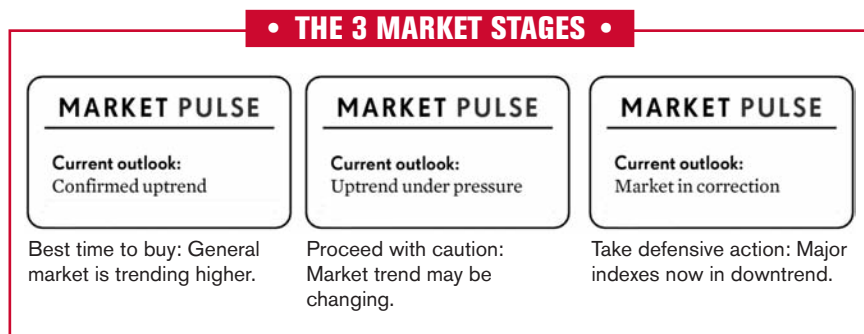
An ETF is essentially a “basket” of stocks compiled into one “fund” that you can buy and sell just like an individual stock. It could be a sector-based ETF focused on a particular industry, such as energy or real estate. Or it could be an index-based ETF that tracks the S&P 500 or another index as a whole.

For this game plan, we'll focus on index-based ETFs that give a broader representation of the general market.

3 Easy Steps

IBD has a simple approach to tracking the general market trend. (We'll get into the details in the Buying Checklist section.)

Each day, you can check the *Market Pulse* in IBD's *The Big Picture* column to see which of 3 possible stages the market is in right now:



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Based on that, you can see if it's time to buy, sell, or hold an index-based ETF. Here's how it works.

• BASIC GAME PLAN FOR MAKING MONEY IN INDEX-BASED ETFs •

Step 1: Buy an index-based ETF when the outlook changes from “Market in correction” to “Confirmed uptrend.”

Step 2: Sell 50% when the outlook changes from “Confirmed uptrend” to “Uptrend under pressure.”

Step 3: Sell the remaining 50% when the outlook changes from “Uptrend under pressure” to “Market in correction.”

Note: In particularly volatile markets, the outlook may change immediately from “Confirmed uptrend” to “Market in correction,” without going through the “Uptrend under pressure” stage. In that case, reduce your index-based ETF holdings to zero when the outlook is “Market in correction.”

Protect Your Money with Stop-Loss Rules

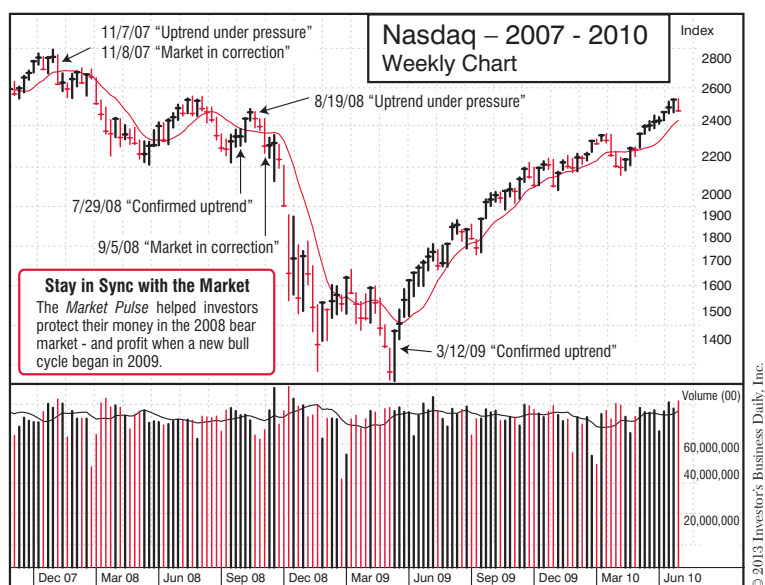
To protect yourself from a sharp market downturn, you can set stop-loss orders ahead of time with your broker (Chapter 4). Here are some simple guidelines you can also follow as part of this ETF trading plan, in conjunction with the 3 steps outlined above:

- Sell 50% of your index-based ETF position if the index closes 0.5% or more below the follow-through day closing price. (A “follow-through day”—see Big Rock #1, Chapter 3—is what triggers a new market uptrend and causes the *Market Pulse* outlook to change from “Market in correction” to “Confirmed uptrend.”)
- Sell 100% of your remaining index-based ETF position if the index drops 2.5% (intraday) below the follow-through day closing price.

Learn More

For more details on using this approach, see the ETF section of IBD.

The following chart shows how this simple approach can help generate significant profits. Think back to the severe bear market that started in late 2007, then look at how the *Market Pulse* alerted readers to that change in trend—and later noted the start of a new bull cycle in March 2009.



How the *Market Pulse* helped investors stay protected in the 2008 bear market, and get back in for the 2009 bull rebound.

How IBD's Approach Nearly Doubled the Nasdaq Performance

Following the 3-step approach listed above, from August 15, 2006 (start of new uptrend) to March 28, 2013 (last trading day of first quarter), IBD's *Market Pulse* strategy gained 97% compared to a 54% gain for the Nasdaq and a 55% gain for the S&P 500. While that does not guarantee you'll get those kinds of gains in every market cycle, it does show how this approach has the potential to generate significant profits.

Keep in mind: *Those gains were generated even with the severe 2008 bear market caused by the housing and financial crisis.*

How many people do you know made—and held on to—a 97% gain from 2006–2012? If you had invested \$10,000 the day after the *Market Pulse* changed to "Confirmed uptrend" on August 15, 2006, it would have grown to over \$19,000 *just by following this simple strategy.*

So whatever your goal is—building a college fund for your kids, paying off your mortgage, having a worry-free retirement—you can see how this approach may help you achieve it over time.

Tips on How to Generate ETF Profits



Check out a short video that shows how you can use stop-loss orders and other simple steps to help generate substantial returns at www.investors.com/GettingStartedBook.

Basic Game Plan for Making Money in Individual Stocks

Now that we've seen how you may make substantial profits investing in index-based ETFs, let's see how to potentially capture even larger gains by buying and selling individual stocks.

Keep in mind: In a strong uptrend, the top-rated CAN SLIM stocks typically go up *much* more than the Nasdaq or S&P 500.

For example, from the start of a new bull market on March 12, 2009, through May 4, 2010, when the market slipped into a downtrend, the Nasdaq gained 70%. During that same period, the market leaders of the time shot up even more: Lululemon Athletica (522%), Ulta Beauty (322%), Baidu (309%), Priceline (231%).

Of course, let's manage expectations and be realistic.

Not even the best investors capture every last dollar of a big winner's move. (In fact, *trying* to do that will just get you into trouble as we'll see later.) But you *can* lock in a good-sized portion of those huge gains—and a little piece of a 300% move means a nice boost for your portfolio.

Yes, it takes more effort and elbow grease to tap into those potentially “monster” gains in individual stocks, but that's why you're reading this book, right? And once you get familiar with the routines and checklists, I think you'll be pleasantly surprised at how you can do this by sticking to a step-by-step approach. (To see what I mean, check out the Simple Weekend Routine in Chapter 4).

And I'll show you how to *get started*, one step at a time, using easy-to-follow checklists. We'll start right now with a quick overview of the basic 3-step game plan.

• BASIC GAME PLAN FOR MAKING MONEY IN STOCKS •

Step 1: Only buy when the overall market is in an uptrend.

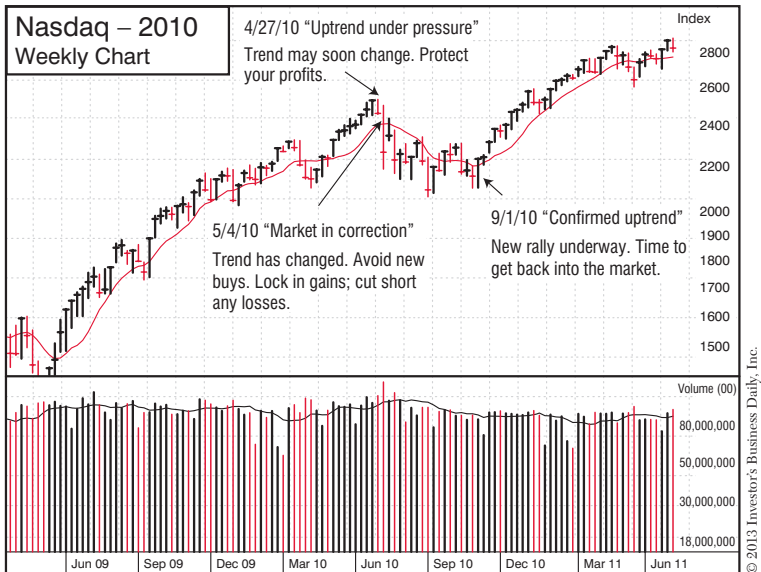
Step 2: Buy stocks with CAN SLIM traits as they break out from a telltale chart pattern.

Step 3: Take most profits at 20% to 25%. Cut all losses at no more than 7% to 8%.

We'll cover the details of each step as we go through the buying and selling checklists. But for now, let's take a peek at these 3 steps in action.

Step 1: Only Buy When the Overall Market Is in an Uptrend

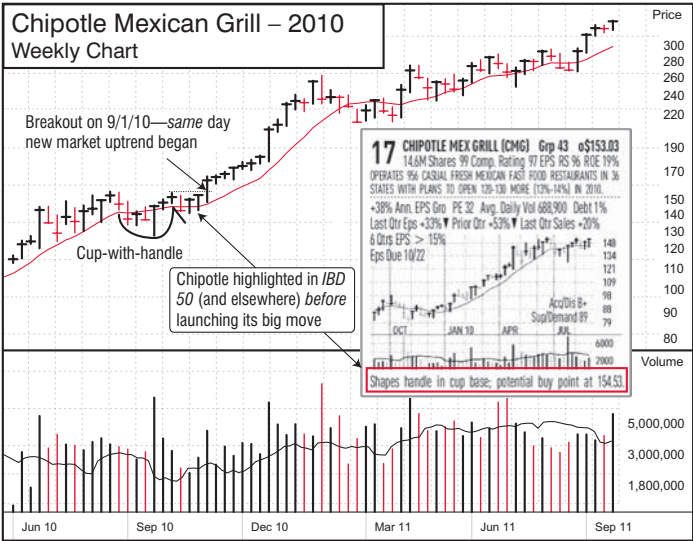
You can always see if the market is in an uptrend or downtrend just by checking the *Market Pulse* in *The Big Picture* column. In the following chart, you can see how the *Market Pulse* outlook helped investors buy and sell at the right time in 2010.



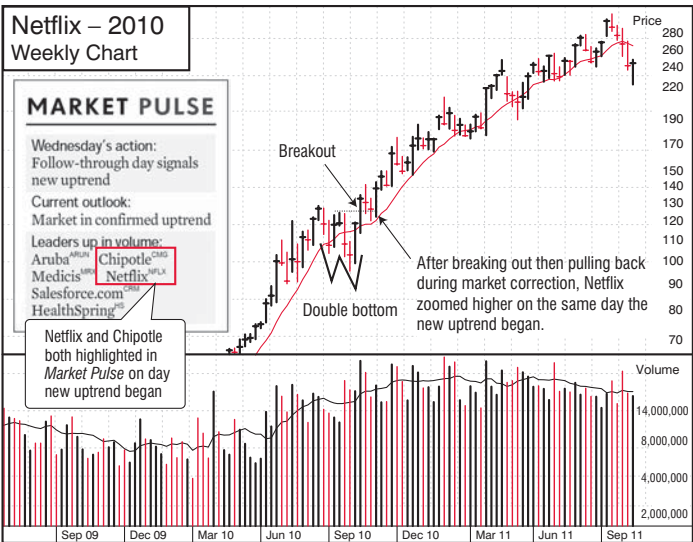
The *Market Pulse*'s 3-stage approach helps you see when to buy and when to take defensive action.

Step 2: Buy Stocks with CAN SLIM Traits as They Break Out of a Telltale Chart Pattern

Even if you’re not yet familiar with charts, you’ll find highlights of top-rated stocks—and alerts to potential buy points—in the *IBD® 50, Your Weekly Review, Sector Leaders*, and other features.



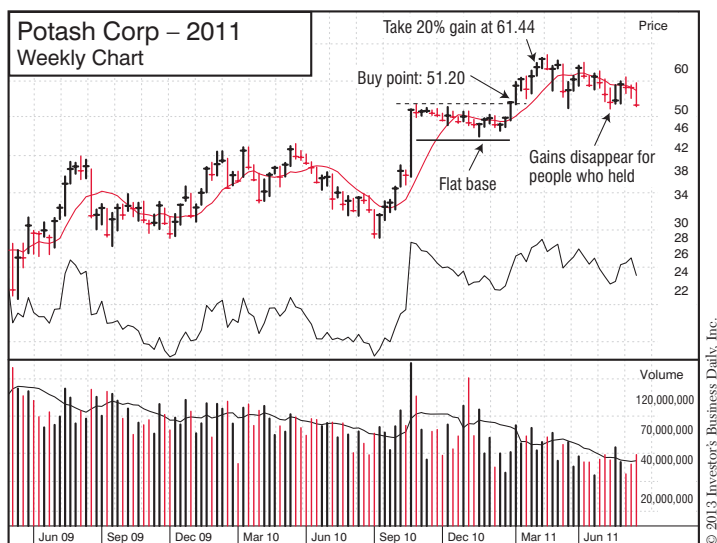
Chipotle Mexican Grill increased 186% from September 2010 to April 2012.



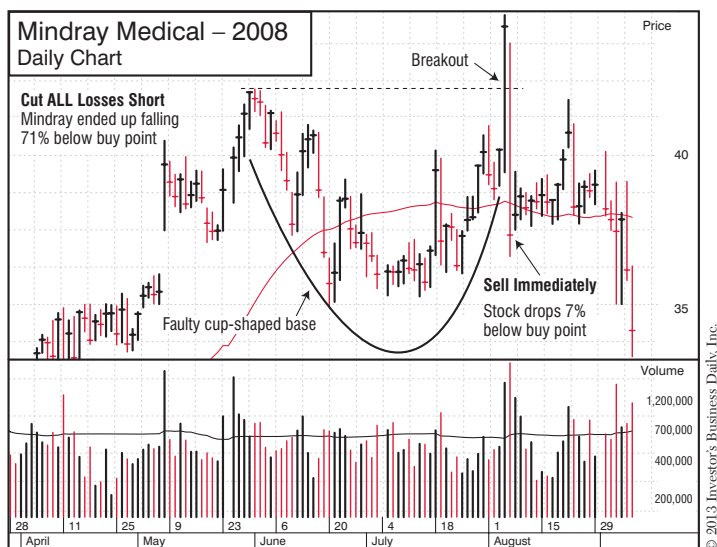
Netflix increased 150% from September 2010 to July 2011.

**Step 3: Take Most Profits at 20% to 25%.
Cut All Losses at No More Than 7% to 8%.**

Start with this simple selling plan to make sure you lock in some good gains and avoid any serious damage.



Take most gains at 20% to 25% to lock in good profits and grow your portfolio.



Never let a little loss become a big one: Always sell if a stock drops 7% to 8% below your purchase price.

“Life is really simple, but we insist on making it complicated.”

—CONFUCIUS

To a large degree, the same can be said of investing.

In the chapters ahead, we’ll go through checklists that outline the traits of winning stocks, and see what buy and sell signals to look for in a chart. Those are all important details that you’ll need to learn to be a successful investor.

But never lose sight of the big picture—and the basic game plans we just went through. With all the news and noise that surrounds the market, it’s easy to overthink investing and become the proverbial deer in the headlights.

So especially if you’re just getting started, stick with the simple game plans and routines we’ll cover in this book. They’ll keep you focused on the big-ticket items that ultimately determine if a stock heads up—or down.

And in the next chapter, we’ll find out what those key factors are.

• ACTION STEPS •

Here are some quick *To Dos* to reinforce and start using what we’ve learned so far. To see how to take these steps, visit www.investors.com/GettingStartedBook.

1. Watch two short videos on:
 - *Simple Weekend Routine*
 - *How to Make Money Trading Index ETFs*
2. Check *The Big Picture* column in IBD or Investors.com.
 - Is the market in a confirmed uptrend—or correction—right now?

2

• CHAPTER •

The CAN SLIM[®] Investment System

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The 3 “Big Rocks” of CAN SLIM Investing

The buying and selling checklists in this book—and all the stock screens and tools you’ll find in IBD®—are based on the **CAN SLIM® Investment System**, developed in the 1960s by IBD founder and chairman William J. O’Neil.

For years now, I’ve had the privilege of helping people get started with CAN SLIM investing—at workshops, in videos, at IBD Meetup groups, in a monthly newsletter, and on our radio show.

There’s one piece of advice I give to anyone just starting out: **Don’t over-complicate it! Keep it simple.**

Yes, there are important details and some things that take a little time and effort to learn, like how to read a stock chart. But all of them can be broken down into a few simple concepts you can learn step by step, using checklists to guide you. And that’s what we’ll do together throughout this book.

I love the saying, “Put the big rocks in first.” You can always add the tiny pebbles—the details—later, but when you’re getting started, make sure you stay focused on what matters most.

When it comes to understanding why the CAN SLIM Investment System works so well and how you can use it to make money in the market, it comes down to 3 “big rocks” you *always* want to put in first:

- **Big Rock #1:** Only buy stocks in a market uptrend. Take defensive action as a downtrend begins.
- **Big Rock #2:** Focus on companies with big earnings growth and a new, innovative product or service.
- **Big Rock #3:** Buy stocks being heavily bought by institutional investors. Avoid those they’re heavily selling.

As you go through this book—and, most importantly, as you start using the checklists and Simple Weekend Routine to invest—always keep those 3 “big rocks” in mind.

They may not make sense to you just yet (they will very soon)—or maybe they seem overly simplistic at first. But IBD’s study of every top stock since 1880 shows that always starting with these 3 core tenets is the key to making money in the market.

The CAN SLIM Concept

CAN SLIM investing is based on two simple ideas:

- To find tomorrow's big winners, look for stocks with the same traits *past* winners had just *before* they launched their big runs.
- To know when it's time to sell, look for the same warning signs these past winners flashed when they eventually topped and began to decline.

What Does a Winning Stock Look Like Before—and After—it Makes Its Big Move?

In the late 1950s, Bill O'Neil was a young broker who asked a simple question: What common traits do the best stocks have *before* they make their big price moves?

To find out, he began studying the biggest winners of all time. These were stocks that went up 100%, 300% or much more very quickly, often in just 1 or 2 years.

These were the days before personal computers and the Internet, so Bill covered his office walls and cabinets with charts and reams of data. He studied every available performance metric to see which ones truly mattered—to see what characteristics and telltale signs these top-performing stocks displayed just before they rocketed higher. He found:

The best stocks display seven common traits just *before* they make their biggest gains.

*Each letter in CAN SLIM stands for one of those traits, and they form the basis of the rules you'll find in the **Buying Checklist**.*

Bill also studied what happens to leading stocks *after* they've had a big run. Just as they share certain traits before they surge, they also flash similar warning signs as they top and begin to decline. Those signals form the basis of the sell rules you'll find in the **Selling Checklist**.

Over 130 Years of Market History

The study O'Neil launched in the 1960s continues to this day and now covers every market cycle and top-performing stock from 1880 to the present.

Whether it's Bethlehem Steel in 1914, Xerox in 1963, Google and Apple in 2004, Priceline.com in 2010, SolarWinds in 2011, or 3D Systems in 2012,

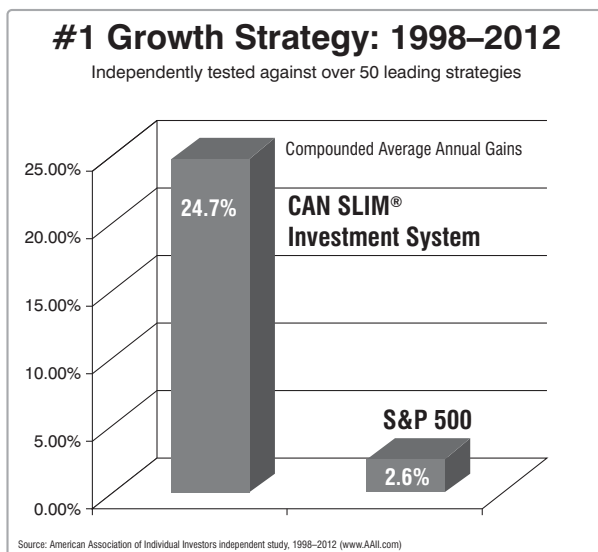
year after year, decade after decade, the biggest winners display these same 7 CAN SLIM traits just *before* they launch their massive runs.

The company names will change, new technology and industries will emerge, but *the basic profile and attributes of an emerging big winner always look the same*. So once you understand what to look for, your search for the next game-changing stock won't be based on hunches or hype. It'll be based on history and a targeted checklist of specific, telltale signs.

Only about 1% to 2% of all stocks will have these CAN SLIM characteristics. But as the results of an independent study by the American Association of Individual Investors (AAII) show, it pays to be picky: *If you stay disciplined and look for stocks with CAN SLIM traits, you will spot today's most promising stocks in the early stages of their big moves.*

#1 Growth Strategy from 1998–2012

Since 1998, the American Association of Individual Investors has been conducting an ongoing, real-time study of over 50 leading investing strategies. From 1998–2012, AAII found the CAN SLIM Investment System was the #1 growth strategy, generating an annualized return of 24.7%.



Think about all of the roller-coaster rides we had in the market during those 15 years: The dot-com boom and bust, the 2003 bull market, the housing and financial crisis in 2008, and the bull market rebound in 2009.

The CAN SLIM Investment System's independently tested performance through all those cycles shows that **if you stick to the Buying and Selling Checklists we'll cover together in this book, you can make—and keep—significant gains in any type of market.**

The 7 Traits of Winning Stocks

In *How to Make Money in Stocks: A Winning System in Good Times or Bad*, Bill O'Neil gives a detailed description of each of the 7 CAN SLIM traits and countless historical examples of winning stocks that shared those characteristics. It's the definitive guide to CAN SLIM investing by the man who developed it, so I strongly encourage you to read that book.

Since the purpose of *this* book is to show you how to quickly *get started* with the CAN SLIM Investment System, we'll take a slightly different approach.

Again, let's keep it simple and stay focused on what really matters most. Here's how we'll do that.

First, I'll give a brief overview of the 7 CAN SLIM traits and show how they relate to the 3 “big rocks” I noted earlier. We'll also go through some CAN SLIM case studies so you can see how top stocks in the 2009–2012 bull market had these same traits *before* they surged.

Then in the next chapters, we'll go step by step through routines and checklists that will help you systematically spot *today's* CAN SLIM stocks and pinpoint the best time to buy—and sell—them.

The 7 Traits and the 3 Big Rocks

See the **Buying Checklist** for the specific numbers and ratings needed to meet the benchmarks for the 7 CAN SLIM traits.

Big Rock #1: Only Buy Stocks in a Market Uptrend.

Take Defensive Action as a Downtrend Begins.

The “M” in CAN SLIM—market direction—may be the last letter, but in many ways it's the most important. To a very large degree, the difference between making or losing money comes down to simply staying in sync with the direction of the overall market (i.e., the major indexes like the S&P 500 and Nasdaq).

M Market direction

History shows 3 of 4 stocks simply follow the direction of the general market, either up or down. So you must learn to follow, not fight, the current trend.

We'll get into what steps you can take to handle changes in market direction later, but understand up front that:

You do *not* need to be fully invested in the stock market at all times. Make money when the market is trending up—and protect your profits when the market starts trending down.

Sounds obvious, right?

But the reality is, many people pay *no* attention to the overall market direction and just blindly “buy and hold.” That's because they don't understand how market cycles work. They don't realize that when the overall market trends down for an extended period, about 75% of all stocks go down with it.

Investors with a “buy and hold” strategy may make money when the market is going up, but they often end up giving it all back (and then some) when it goes down.

It's time to step off that roller coaster and start using buy and sell rules based on how market cycles actually work.

You'll learn how to do that in this book:

- The Buying Checklist pinpoints the best time to get into the market.
- The Selling Checklist shows you when it's time to lock in your gains and move to the sidelines.

Big Rock #2: Focus on Companies with Big Earnings Growth and a New, Innovative Product or Service.

Big, accelerating earnings growth is the #1 factor to look for in a stock. And it's innovative companies with game-changing new products that generate that type of explosive profitability.

That's why the first three CAN SLIM traits are so important:

C Current quarterly earnings per share (EPS)

Earnings should be strong and accelerating in recent quarters. Plus, to prove the company has the ingredients to sustain that growth, look for solid sales growth, a high return on equity, and industry-leading profit margins.

A Annual earnings per share

To help make sure the current quarterly growth is not a fluke, also look for strong *annual* earnings growth over the last 3 years.

N New company, product/service, industry trend, or management

Focus on companies with something “new”: An innovative product or service in high demand, a new CEO, or a game-changing industry trend.

Think about it: If a stock’s share price goes up 100%, 200% or more, there has to be a reason. There has to be *something* that is making mutual fund managers and other big investors continue to push the stock higher.

History shows the main cause is earnings growth. And that was proven again in the 2009–2012 bull market. The biggest winners—stocks like Baidu, F5 Networks, Apple, Priceline.com, SolarWinds, Rackspace Hosting, Alexion Pharmaceuticals, Lululemon Athletica, Chipotle Mexican Grill, and Michael Kors—tended to be highly profitable companies whose earnings growth was not only strong but accelerating as their share prices rose higher. And they all had new, innovative products or services that made them leaders in their industries.

Big Rock #3: Buy Stocks Being Heavily Bought by Institutional Investors. Avoid Those They’re Heavily Selling.

“Institutional investors”—primarily mutual funds but also hedge funds, banks, pension funds, insurance companies, and other large “institutions”—account for the bulk of all trading. They provide the buying power or fuel a stock needs to make a big, sustained upward move. And when they sell, it’s their heavy dumping of shares that drives a stock down.

That’s why it’s absolutely critical to watch what they’re doing—and you’ll see how to do that using IBD *SmartSelect*® Ratings and charts when we get to the Buying Checklist.

For now, just understand you essentially want to ride their coattails. You want to buy stocks fund managers and other big investors are heavily buy-

ing, since those are the stocks most likely to make a big gain. And just as importantly, you want to sell and get out of the way when you see fund managers start to unload their shares, since those stocks will likely drop sharply.

The next 3 CAN SLIM letters outline the kind of institutional buying you want to see in a stock *before* you invest:

S Supply and demand

At key buy points, the best stocks will have *above-average* increases in volume (i.e., a sharp rise in the number of shares traded). That shows fund managers and other professional investors are heavily buying that stock.

L Leader or laggard

Focus on the top-rated stocks in the top-ranked industry groups. A stock becomes a true leader by showing strong earnings and innovation (“C,” “A” and “N” in CAN SLIM) *and* by being the clear leader in a top-ranked group—where institutions are putting their money.

I Institutional sponsorship

“Institutional sponsorship” refers to ownership of a stock by large institutions, primarily mutual funds. Look for an *increasing* number of funds owning a stock in recent quarters, plus ownership by a few top fund managers that have outperformed the market over the last one or two years. It’s good confirmation to see these top investors buying a stock you’re considering.

Follow the Funds!

*“It’s key to buy the better stocks mutual funds buy and avoid ones they may be selling on a heavy basis. **Trying to go against this monumental amount of trading will only hurt your results.**”*

—WILLIAM J. O’NEIL, IBD CHAIRMAN AND FOUNDER

Bottom line: Make sure some mutual fund managers are moving heavily into a stock before you buy. And when they start to sell aggressively, move to the sidelines and get out of the way.

• WHAT ABOUT P/E RATIOS? •

You may have noticed there was no mention of price/earnings (P/E) ratios among the 7 traits of winning stocks. The reason is simple: Our studies show P/E ratios (share price divided by earnings-per-share) are not an important factor in a stock's price movement and have very little to do with whether a stock should be bought or sold.

That may come as a shock since most investors are told to focus on stocks with a low P/E ratio and avoid those with a high one. But the fact is, 130+ years of market history show that **investors who fixate on low P/E ratios miss out on virtually every big winner.**

Here's why.

A low P/E ratio is usually a sign of weakness, not strength. The strongest stocks—those with big earnings growth and other CAN SLIM traits—will typically have a higher P/E ratio. Why? Because institutional investors are willing to pay more for quality, fast-growing stocks. A baseball team has to pay more to sign a .300 hitter averaging 40 home runs a year than to sign a benchwarmer with a .200 batting average. As the table below shows, it's the same in the stock market: You get what you pay for.

P/E Ratios of Leaders in 2009–2012 Bull Market

Company	Year Run Started	P/E at Start of Run	Subsequent % Gain
Baidu	2009	69	322%
Green Mountain Coffee Roasters	2009	36	1104%
Priceline.com	2010	29	183%
Lululemon Athletica	2010	33	196%
SolarWinds	2011	28	137%

If you focus only on low P/Es, you're essentially taking the best merchandise off the shelf and restricting yourself to the clearance bin. So instead, focus on stocks with big and accelerating earnings growth. That's the true mark of a potential big winner.

CAN SLIM® Case Studies

A new crop of leading stocks emerges in every bull market cycle, giving you new opportunities to make money.

Some will be household names, but many will be companies you've likely never heard of. You may not be familiar with their products or services, but now that you know the 7 CAN SLIM traits to look for, you'll know how to spot them—and you'll see where to find them using the Simple Weekend Routine (Chapter 4).

Below are profiles of 3 CAN SLIM winners.

One is a company we all know—Apple. But back in 2004 when it launched a massive run that would turn it into the world's most valuable company by 2012, was it on your radar screen?

You'd probably heard of the iPod and iTunes, maybe even used them. But as an investor, did you make the connection that with a revolutionary, extremely popular new product (the “N” in CAN SLIM), Apple could become a big stock market winner?

The iPod generated explosive earnings growth, and that was followed by even more profits with the release of the iPhone. Those two game-changing innovations revolutionized the music and mobile phone industries, leading to a 1,418% rise in Apple's share price in less than 4 years.

But even if you missed that *entire* move, Apple still offered new opportunities to get in during the 2009–2012 bull market. (As you'll see later in the book, it's rare for a stock that leads in one bull market cycle to come back and lead in the next one too. That's why it's so important to always hunt for the *new* crop of leaders. More on that later.)

Like most stocks, Apple got hammered during the 2007–2008 financial crisis, but when the market turned around in 2009, Apple came roaring back. What gave it that kind of power? As you can see in the case study below, it still had the CAN SLIM traits, including big earnings and sales, hot new products, and growing demand from fund managers. And that was *before* it released yet another new innovation—the iPad.

Unlike Apple, the other two case studies, Green Mountain Coffee Roasters and Ulta Beauty, were not household names when they launched their big price moves. I had never heard of them before they started show-

ing up in IBD's stock lists—and until my teenage daughter tipped me off to the popularity of Ulta Beauty, which sells brand-name cosmetics at discount prices.

That brings up an important side note: Pay attention to where your children shop. They might steer you to a new leader in the retail industry, which has been a good source of CAN SLIM stocks over the years.

But back to the case studies. While you might not have tasted Green Mountain's K-Cup gourmet coffee or visited an Ulta store, as a CAN SLIM investor, their superior earnings performance would have put them on your radar screen. Both companies had the traits we look for, and that's why they started appearing in stock lists like the *IBD 50* (known as the *IBD 100* at the time) and *Your Weekly Review*.

As you look through these profiles, note how the 3 “big rocks” were all in place when these stocks launched their big moves:

- The overall market was in an uptrend.
- Each company had explosive earnings growth and innovative products.
- Mutual funds were aggressively buying shares.

These types of money-making opportunities appear in every bull market cycle. And by studying these examples and by using the checklists and routines we'll go over throughout this book, you'll see exactly what steps you can take to profit from them.

How to Find & Own America's Greatest Opportunities by Bill O'Neil



Each week, Bill O'Neil personally writes a short column that walks you through the full “life cycle” of a winning stock. You'll see what CAN SLIM traits it had before it made its big price move—and what sell signals it eventually flashed. Reading Bill's insights each week will help you spot tomorrow's big winners—and handle them profitably when you do. See a sample column at www.investors.com/GettingStartedBook.

CAN SLIM Case Study: Apple (AAPL)

381% gain from July 2009–September 2012

All 3 “big rocks” and key CAN SLIM® traits in place **before** breakout.

Only buy stocks when the overall market is in an uptrend.

Market Direction: New bull cycle had just begun in March, following the 2008 housing and financial crisis.

Focus on companies with big earnings growth and a new, innovative product or service.

Current Earnings: EPS growth in 3 quarters prior to big move: 37% → 47% → 61%.

Annual Earnings: Average 3-year annual EPS growth: 48%.

New Product/Service: Apple’s iPods, iPhones, iTunes, and apps market made it the innovative leader in the music and smartphone industries and also sparked new interest and market share for its line of Mac computers.

Buy stocks being heavily bought by institutional investors.

Supply and Demand: Apple’s Accumulation/Distribution Rating of B+ (see Buying Checklist) showed institutional investors had been scooping up shares over the prior 3 months.

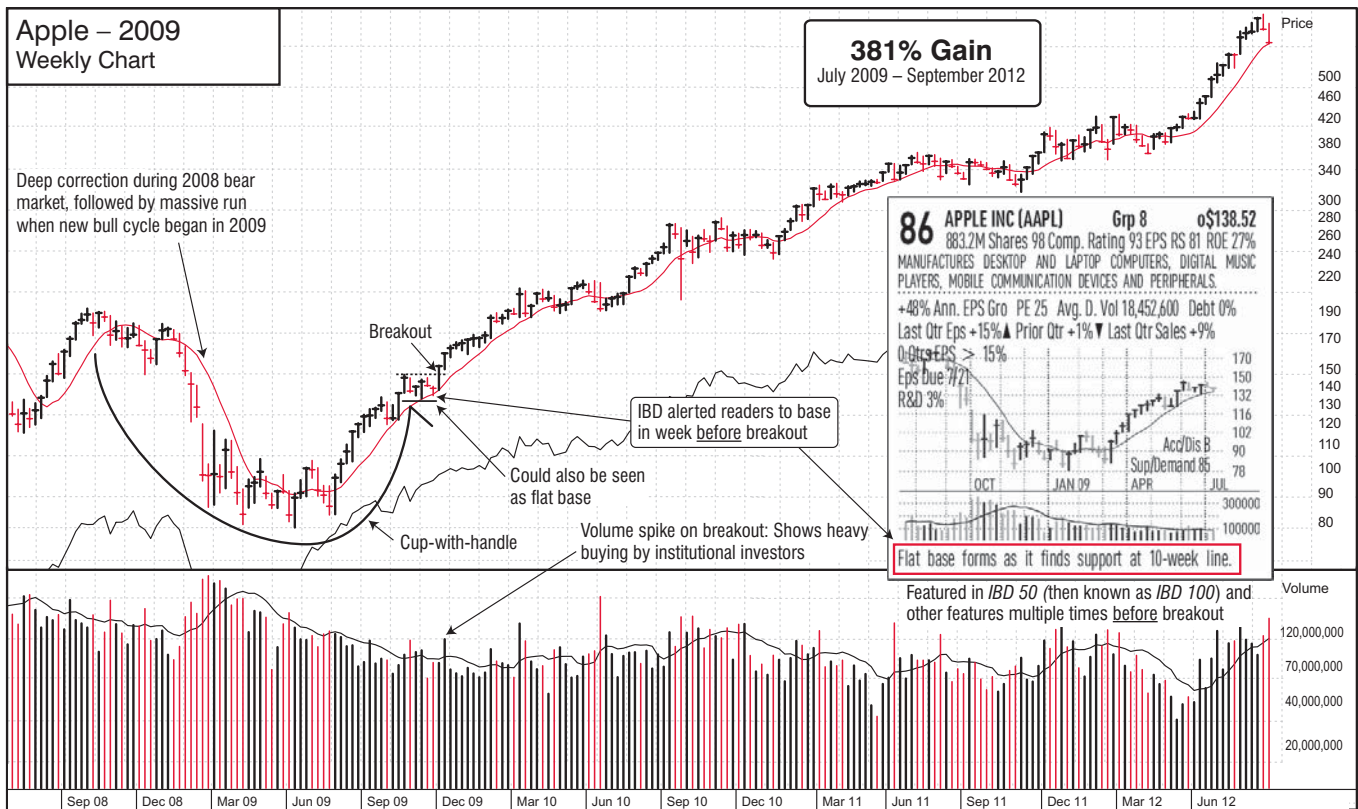
Leader or Laggard: 98 Composite Rating showed Apple was outperforming 98% of **all** stocks in terms of key CAN SLIM traits.

Institutional Sponsorship: Number of funds owning Apple rose in 3 quarters before it launched its new run: 286 → 316 → 321.

Apple – 2009 Weekly Chart

381% Gain
July 2009 – September 2012

Deep correction during 2008 bear market, followed by massive run when new bull cycle began in 2009



CAN SLIM Case Study: Green Mountain Coffee Roasters (GMCR)

1,104% gain from March 2009–September 2011

All 3 “big rocks” and key CAN SLIM® traits in place *before* breakout.

Only buy stocks when the overall market is in an uptrend.

Market Direction: Green Mountain launched its new run just days after a new bull cycle began on March 12, 2009. Bullish sign: Stocks that go on to big gains often start their runs right when a new market uptrend begins.

Focus on companies with big earnings growth and a new, innovative product or service.

Current Earnings: Green Mountain's 93 EPS Rating (see Buying Checklist) showed it was outperforming 93% of all stocks for both current and annual earnings growth. Sales jumped 56% in the prior quarter.

Annual Earnings: Average 3-year annual EPS growth: 43%.

New Product/Service: Green Mountain was stirring up the coffee industry with its Keurig K-Cup single-serving gourmet coffees.

Buy stocks being heavily bought by institutional investors.

Supply and Demand: Green Mountain's 97 Relative Strength Rating (see Buying Checklist) told you its price performance was outpacing 97% of all stocks.

Leader or Laggard: Highest-possible 99 Composite Rating showed GMCR was in top 1% of *all* stocks for key CAN SLIM traits.

Institutional Sponsorship: Number of funds owning GMCR rose sharply in 3 quarters prior to breakout: 183 → 197 → 219.

Green Mountain Coffee Roasters – 2009 Weekly Chart

GREEN MTN COFFEE ROASTERS (GMCR) Grp 33 o\$41.10
 19.0M Shares 99 Comp. Rating 93 EPS RS 97 ROE 21%
 DISTRIBUTES COFFEES AND TEAS, SINGLE CUP BREWERS AND SINGLE CUP
 PORTION PACKS TO SUPERMARKETS, FOOD STORES AND OTHER.
 +43% Ann. EPS Gro PE 41 Avg. Daily Vol 588,600 Debt 89%
 Last Qtr Eps +14% Prior Qtr +76% Last Qtr Sales +56%
 0 Qtrs EPS +15%
 Eps Due 07



Cup with handle appears with buy point at 42.99.

Featured in *Your Weekly Review* and other
features multiple times before breakout

IBD alerted readers to buy point
week before breakout
(42.99 buy point at time. This chart
shows split-adjusted prices.)

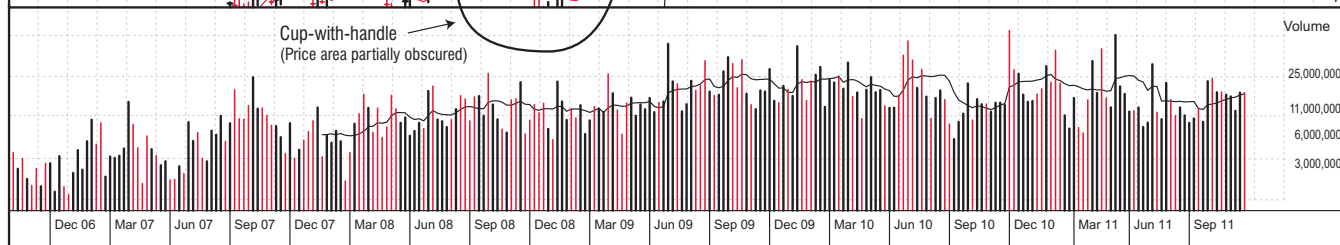
Breakout

3/2 Stock Split

3/1 Stock Split

Split-adjusted prices

Cup-with-handle
(Price area partially obscured)



1,104% Gain
 March 2009 – September 2011

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CAN SLIM Case Study: Ulta Beauty (ULTA)

165% gain from September 2010–July 2011

All 3 “big rocks” and key CAN SLIM® traits in place **before** breakout.

Only buy stocks when the overall market is in an uptrend.

Market Direction: New uptrend had begun just 2 weeks earlier.

Focus on companies with big earnings growth and a new, innovative product or service.

Current Earnings: EPS growth in 3 quarters prior to big move: 56% → 62% → 188%.

Annual Earnings: Average 3-year annual EPS growth: 31%.

New Product/Service: Ulta was revolutionizing the cosmetics retail business with a Home Depot–style, big-store format featuring a wide range of popular brand items at discount prices.

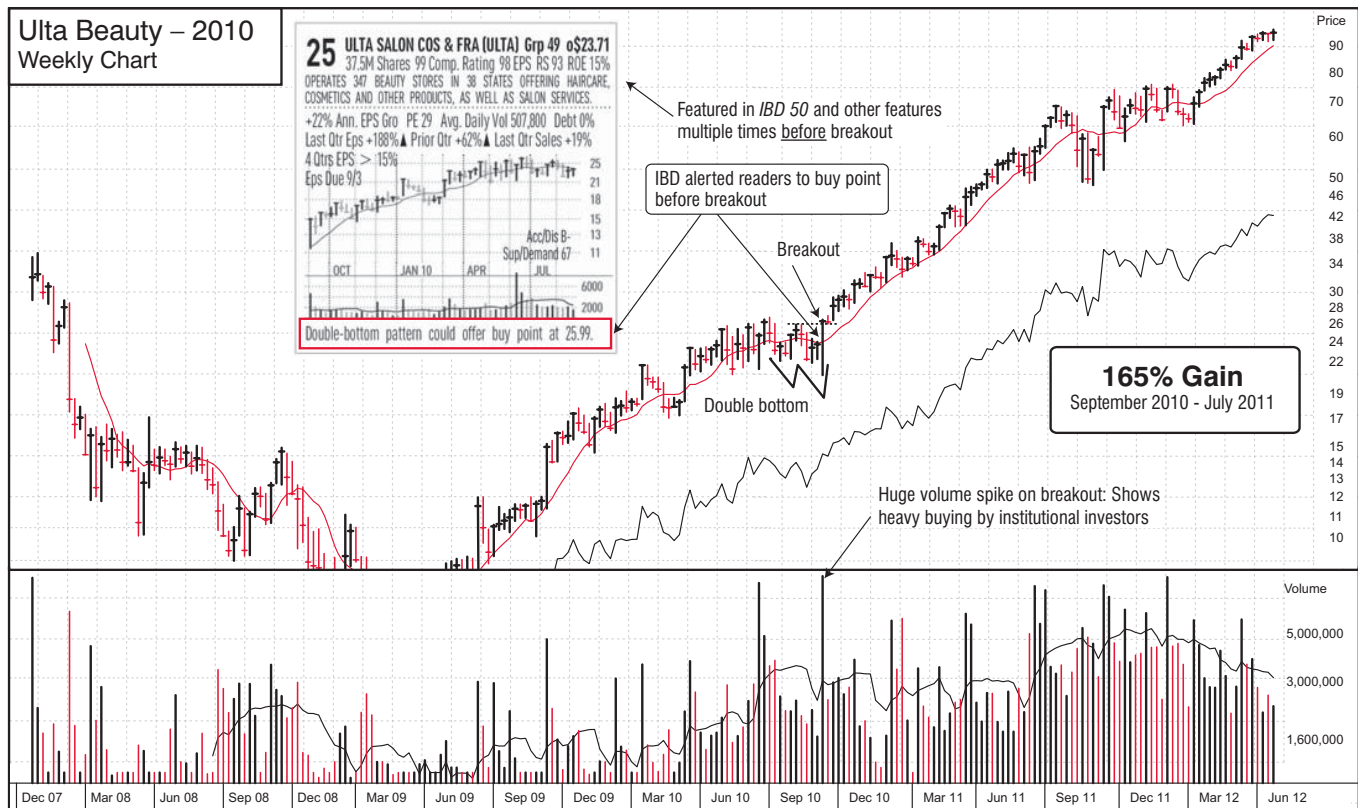
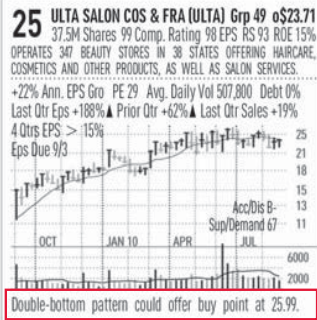
Buy stocks being heavily bought by institutional investors.

Supply and Demand: Weekly trading volume was 207% **above** average the week ULTA started its run, showing fund managers were aggressively buying shares.

Leader or Laggard: 96 Composite Rating told you Ulta was outperforming 96% of **all** stocks in terms of key CAN SLIM traits.

Institutional Sponsorship: Number of funds owning ULTA rose sharply in 4 quarters **prior** to breakout: 197 → 223 → 231 → 315.

Uita Beauty – 2010 Weekly Chart



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Next Up: How to Find *Today's* CAN SLIM Stocks

Now that you know what to look for, let's see how to find stocks that have these same CAN SLIM traits *right now*. We'll do that using a Buying Checklist that shows you what specific traits to look for before you invest.

But first, take the Action Steps below to help reinforce what we covered in this chapter.

• ACTION STEPS •

Here are some quick *To Dos* to help you get more familiar with and start using the CAN SLIM Investment System. To take these steps, visit www.investors.com/GettingStartedBook.

1. See CAN SLIM investing in action with these short videos:
 - *How to Spot Great Story Stocks*
 - *When to Get Into—and Out of—the Market*
2. See what's "new" with today's top-rated CAN SLIM stocks.
 - Check the top 5–10 stocks in the current *IBD 50* list.
 - You can also use stocks from the *CAN SLIM Select* list in the *IBD Screen Center* on Investors.com.
 - Check their websites and read about them on Investors.com to find out what new products or services they offer and what industry trends are driving their growth.

3

• CHAPTER •

Buying Checklist

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Buying Checklist

Does Your Stock Pass or Fail?

Make sure the 3 “Big Rocks” of CAN SLIM® are always in place before you invest.

Use this checklist to see if your stock has the CAN SLIM traits big winners typically display just *before* they launch a major price move.

Big Rock #1: Only buy stocks in a market uptrend. Take defensive action as a downtrend begins.

- ☐ Market in confirmed uptrend

Big Rock #2: Focus on companies with big earnings growth and a new, innovative product or service.

- ☐ Composite Rating of 90 or higher
- ☐ EPS Rating of 80 or higher
- ☐ EPS growth 25% or higher in recent quarters
- ☐ Accelerating earnings growth
- ☐ Average Annual EPS growth 25% or more over last 3 years
- ☐ Sales growth 25% or higher in most recent quarter
- ☐ Return on equity (ROE) of 17% or higher
- ☐ SMR® Rating (Sales + Margins + Return on Equity) of A or B
- ☐ New products, service, or management
- ☐ Among the top-rated stocks in its industry group
- ☐ Ranked in top 40–50 of IBD’s 197 industry groups

Big Rock #3: Buy stocks being heavily bought by institutional investors. Avoid those they’re heavily selling.

- ☐ Increase in number of funds that own the stock in recent quarters
- ☐ Accumulation/Distribution Rating of A or B
- ☐ Relative Strength Rating of 80 or higher
- ☐ Share price above \$15
- ☐ Average daily volume of 400,000 shares or more

Chart Analysis: Buy stocks as they break out of the common patterns that launch big moves.

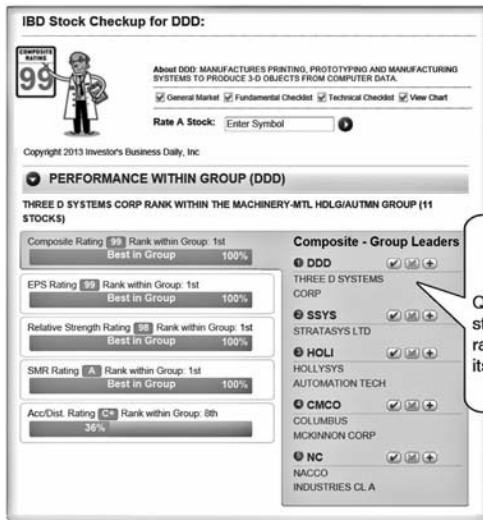
- ☐ Breaking out of sound base or alternative buy point
- ☐ Volume at least 40% to 50% above average on breakout
- ☐ Relative strength line in new high ground
- ☐ Within 5% of ideal buy point

You can download and print this checklist at www.investors.com/GettingStartedBook.

Does Your Stock Pass or Fail?

Find Out with IBD Stock Checkup®

Before we go over each item on the Buying Checklist, note that you can *quickly* see if your stock passes or fails using *Stock Checkup* on Investors.com. You'll find Pass (green), Neutral (yellow) or Fail (red) grades for most items.



Leader or Laggard?

Quickly see if your stock is a top-rated leader within its industry group.

☒ **IBD® Stock Checklist**

Composite Rating 99

GENERAL MARKET AND INDUSTRY GROUP (DDD)

General Market

Market in confirmed uptrend

Industry Group

Industry Group Rank 6

FUNDAMENTAL PERFORMANCE (DDD)

Current Earnings		
EPS Due Date	02/25/2013	
EPS Rating	99	●
EPS % Chg (Last Qtr)	78%	●
Last 3 Qtrs Avg EPS Growth	55%	●
# Qtrs of EPS Acceleration	1	●
EPS Est % Chg (Current Qtr)	137%	●
Estimate Revisions	4	○
Last Quarter % Earnings Surprise	18.5%	●
Annual Earnings		
3 Yr EPS Growth Rate	180%	●
Consecutive Yrs of Annual EPS Growth	3	●
EPS Est % Chg (Current Yr)	70.83%	●
Sales, Margin, ROE		
SMR Rating	A	●
Sales % Chg (Last Qtr)	57%	●
3 Yr Sales Growth Rate	45%	●
Annual Pre-Tax Margin	16.6%	●
Annual ROE	18.0%	●

Pass or Fail?

Get pass (green), neutral (yellow), or fail (red) ratings for most items on the *Buying Checklist*.

See the Checklist and *Stock Checkup* in Action

Watch a short video on how to quickly run your stock ideas through the Buying Checklist at www.investors.com/GettingStartedBook.

It Pays to Be Picky

As we go through each item, keep in mind the concept behind this checklist.

We just saw how the CAN SLIM Investment System outlines what traits the best-performing stocks typically have just *before* they launch a major price move. The Buying Checklist helps you see which stocks have those same traits *right now*.

Stocks that pass this test are the ones most likely to go up 50%, 100%, 200% or even more. You'll see countless examples of stocks that did just that as we check off each item.

Using the Buying Checklist will become second nature very quickly. Once you've done it a few times, you'll be surprised at how fast you can evaluate *multiple* stocks. And since you'll know exactly what characteristics to look for, it won't be difficult to separate the leaders from the laggards.

Practice Now with *Stock Checkup*

If you're near a computer, I suggest you pull up *Stock Checkup* as we go through each item on the checklist. It'll help you get used to the process even quicker. See how at www.investors.com/GettingStartedBook.

Forget All the Hype, Hunches and Hearsay

All too many investors choose stocks based on little more than tips, opinions and rumors. You might hear a pundit say a stock that just fell 30% is now “undervalued.” Or an investing newsletter might promote a company with no sales and profits but a “promising” product in the pipeline. Going on nothing more than a hunch or interesting story, many folks will just jump right in.

But that kind of wishful-thinking, impulsive speculation rarely ends well. Fortunately, it's also totally unnecessary.

You'll find that having rules and checklists—and sticking to them—will be the real “secret” to increasing the amount of money you make.

So instead of picking stocks based on hype and hunches, focus on the *facts*. **Use the Buying Checklist to make each stock prove itself before you buy.**

Think of using this checklist like building the foundation of your home. If you want to create a solid portfolio, don't start by cutting corners and using cheap, inferior materials. Take the time up front to do it right. If you focus on stocks that have these CAN SLIM traits, you'll be creating a solid foundation for success rather than a shoddy structure that more closely resembles a house of cards.

Stay disciplined and picky. Only about 1% to 2% of stocks will make the grade, but that's the point: You're not looking for unproven or run-of-the-mill companies. You only want the best-of-the-best A players on your team. The Buying Checklist will help you build that winning lineup.

• CHECK THE CHART BEFORE YOU BUY •

Make sure your stock also passes the "Chart Analysis" section of the checklist before you invest. We'll get into how to do that in Chapter 6, "Don't Invest *Blindly*: Use Charts to *See* the Best Time to Buy and Sell."

You'll find chart-reading is the most important investing skill you'll ever learn. And once you know what to look for, it's not that hard to do. You'll also find features like the *IBD 50* and *Your Weekly Review* do a lot of the checklist legwork for you. They highlight stocks near a potential buy point and note what kind of chart pattern they're forming.

So even as you're still getting familiar with charts, you can use IBD stock lists and the **Simple Weekend Routine** (Chapter 4) to catch winning stocks *before* they launch their big moves.

Big Rock #1: Only Buy Stocks in a Market Uptrend. Take Defensive Action as a Downtrend Begins.

It's no coincidence that the very first item on the Buying Checklist deals with general market direction.

The reason is simple: **A stock may earn stellar grades for the first six CAN SLIM® traits, but if the “M” (Market Direction) fails, look out!**

We touched on this earlier, but we'll come back to it again and again because it's critical that you understand this *fact* and take it to heart:

3 of 4 stocks simply move in the same direction as the general market, either up or down.

How does that impact *you*?

- If you buy during a market *uptrend*, you have a 75% chance of being *right*.
- If you buy during a market *downtrend*, you have a 75% chance of being *wrong*.

I think you'll agree: That's a *very* compelling reason to stick with the checklist and only buy stocks when the market is in an *uptrend*.

Of course, the question is: How can you tell which way the market is trending right now?

Let's find out using the checklist . . .

Buying Checklist

Big Rock #1: Only buy stocks in a market uptrend. Take defensive action as a downtrend begins.

☐ Market in confirmed uptrend



Market in confirmed uptrend

As we saw earlier, the general market is always in 1 of 3 stages: “Confirmed uptrend,” “Uptrend under pressure,” or “Market in correction.”

You can see which stage we’re currently in just by checking the *Market Pulse* inside *The Big Picture* column found in IBD every day. (In Chapter 5, “Selling Checklist,” we’ll cover what to do when the market stage is “Uptrend under pressure” or “Market in correction.”)

• THE 3 MARKET STAGES •

MARKET PULSE

Current outlook:
Confirmed uptrend

The best time to buy stocks

MARKET PULSE

Current outlook:
Uptrend under pressure

Proceed with caution
Be ready to take defensive
action

MARKET PULSE

Current outlook:
Market in correction

Avoid making new buys
Lock in gains and cut short
any losses

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Can You Really Time the Market?

Conventional wisdom says no. Actual market *history* says yes.

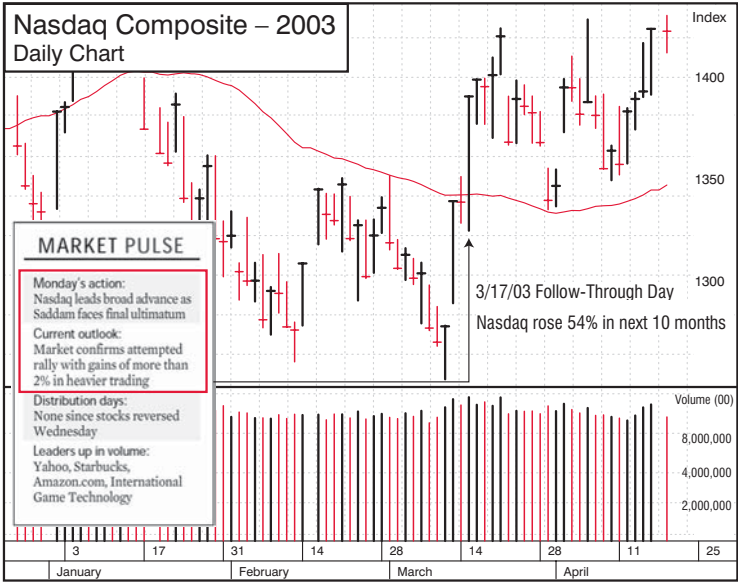
The *Current Outlook* in the *Market Pulse* changes based on certain signals that appear *every time* a major shift in trend occurs.

Now keep in mind: Saying you can time the market does *not* mean you’ll sell at the very top and buy at the very bottom. And it does *not* mean you can predict where the market will be six months from now.

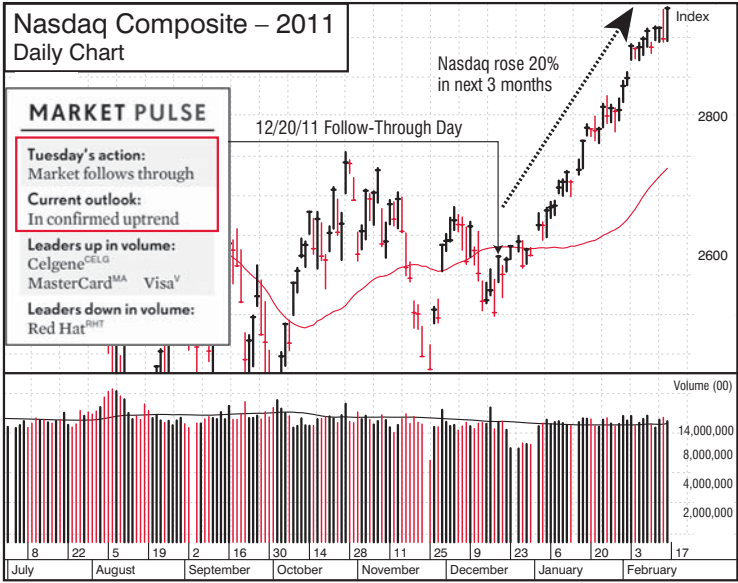
But it *does* mean you can spot when a potential new uptrend has begun. And you can see when the market is starting to weaken and roll over into a downtrend.

This isn’t about predicting the future. It’s simply about understanding what is going on in the major indexes *right now*: Are institutional investors pushing the indexes higher by continuing to buy, or are they driving the market down by selling more aggressively?

No crystal ball required here: Simply understanding the *current* direction is enough to build yourself a financially secure *future*. As you can see in the next two figures, following the 3 stages in the *Market Pulse* will help you make money when the market is up—and protect those profits when selling pressure mounts and a downtrend begins. (Also go back and look at the two examples we covered in Chapter 1, “Start Here.”)



Following the bear market caused by the dot-com bust, the *Market Pulse* alerted readers to the start of a new uptrend.



After several months of volatility, the *Market Pulse* noted the start of a new uptrend in December 2011, giving investors a chance to profit as leading stocks launched new runs.

“See” How to Time the Market



Learn more about how to spot changes in market trends with short videos at www.investors.com/GettingStartedBook.

Two Signs of a Change in Market Trend

Below is a brief explanation of the two main signals that indicate a shift in market direction: “Follow-through days” that note the start of a new uptrend, and “distribution days” that alert you to a weakening market.

Since this book is focused on helping you *get started*, I’ll just cover the basics here. You can dig deeper by taking the Action Steps at the end of this chapter and by doing the “Must-Do Steps” we discussed in the Introduction.

You *Don’t* Have to Track These Changes on Your Own

If the market shifts from a correction to an uptrend or vice versa, you’ll know it just by looking at the *Market Pulse*. So while it’s definitely helpful to understand the mechanics behind follow-through days and distribution days, don’t worry if it doesn’t sink in on the first go. Remember, investing is a skill best learned in stages. You can dig into more details and advanced topics later.

“Follow-Through Days” Mark Start of New Uptrend

When the market is in a correction, how can you tell if the direction has changed and a new uptrend has begun?

Look for a “follow-through day.”

IBD’s ongoing study of *every* market cycle since 1880 has found that **no sustained uptrend has ever begun without a follow-through day**.

So when you’re in a down market and wondering when it’ll be time to get back in, don’t guess. Wait for this time-tested signal to appear and the *Market Pulse* outlook to shift from “Market in correction” to “Confirmed uptrend.”

How Does a Follow-Through Day Work?

Let’s answer that by seeing how the March 12, 2009 follow-through day marked the end of the severe 2008 bear market and the start of a robust new bull cycle.

Think back to what the mood in the country was at that time. In 2007–2008, the housing market had tanked, and the entire financial system had been

shaken to the point of near collapse. The Nasdaq had lost over half its value since the start of the bear market in November 2007, and countless investors had suffered similar losses. (Of course, anyone who followed the Selling Checklist in this book would have avoided any serious damage. Hint, hint . . .)

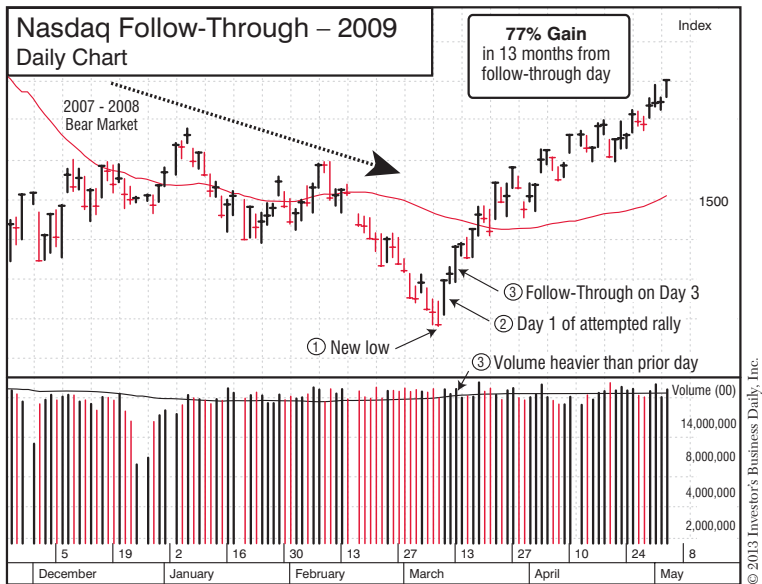
So by March 2009, a lot of folks had taken a beating and were in no mood to jump back into the stock market anytime soon. The doom and gloom headlines only seemed to confirm those fears.

But for investors who understood how market cycles work, the signs of a potential new uptrend were there—as were the tremendous money-making opportunities that emerge at the beginning of every new bull market.

That brings up another important fact: **New market uptrends tend to begin when the economic and other news is *bad*.**

That’s why the follow-through day is such a valuable tool: Instead of wringing your hands at the latest headlines and trying to guess when the market might turn around, just wait for a follow-through day, knowing that new uptrends *never* begin without one.

We’ll get into how to read charts later in Chapter 6, “Don’t Invest *Blindly*,” but for now let’s just walk through the “story” the Nasdaq chart was telling you as the market began to rebound.



See below for an explanation of points 1 through 3 and how follow-through days alert you to new market uptrends.

1. **New Low:** When the market is in a downtrend, look for at least one of the major indexes (S&P 500, Nasdaq, or Dow) to hit a new price low. The Nasdaq did that on March 9, 2009 (Point 1 in the previous chart).
2. **Attempted Rally:** After hitting that new low, look for a day when the index closes higher. That *might* mean the index has stopped its decline, established a new “bottom,” and is on its way to a rebound.

The Nasdaq did that on March 10, when it made a nice gain on higher-than-normal volume (Point 2). What does that above-average volume tell you? That institutional investors are buying—a bullish sign. But one up day isn’t enough to tell if the market trend has truly changed. So we count that as Day 1 of an *attempted* rally.

3. **Follow-Through Day:** Once the attempted rally is under way, we start looking for a follow-through day to confirm that a new uptrend has begun. Here are the basic requirements:
 - Typically occurs sometime after Day 3 of the attempted rally. Many occur between Days 4–7, but they can come later. The March 12, 2009, follow-through actually occurred on Day 3, which is fairly rare (Point 3).
 - The index should make a big one-day price gain, typically 1.5% or higher, on volume *heavier* than the prior day.

Get Back in *Gradually* After a Follow-Through Day

Not every follow-through day leads to a big, sustained uptrend. About one-third will fail, and the market will quickly fall back into a correction. That’s why you want to get back into the market *gradually* when a follow-through day occurs and the *Market Pulse* shifts from “Market in correction” to “Confirmed uptrend.”

If the uptrend takes hold and the leading CAN SLIM stocks start to move higher on heavy buying by institutional investors, you can start to get in more aggressively. If the uptrend fails, use the Selling Checklist and move safely back to the sidelines.

What to Do When a New Uptrend Begins



See my 2-Minute Tip video on “What to Do After a Follow-Through Day” at www.investors.com/GettingStartedBook.

“Distribution Days” Alert You to a Weakening Market

When the market is in an uptrend, you know at some point the tide will turn and a new downtrend will begin. You can see when that shift may be occurring by looking for what we call “distribution days”—days of heavy selling in the major indexes. (“Distribution” is just another word for selling.)

A distribution day is when one of the major indexes closes down at least 0.2% on volume heavier than the day before. (Stalling action—when the trading volume increases, but the closing price barely budes—can also count as distribution.)

We’ll get into how to handle a weakening market when we go through the Selling Checklist, but here’s the key point: **A rising number of distribution days shows that institutional investors are beginning to sell more aggressively.** And we’ve already seen, it’s the enormous buying (and selling) power of mutual funds and other big investors that ultimately drives the market—and individual stocks—either up or down.

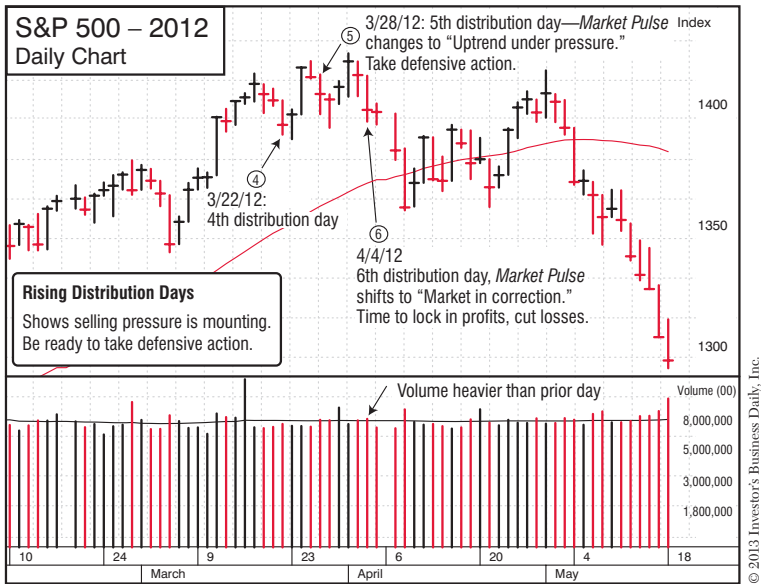
Of course, fund managers try not to sell so aggressively that it becomes obvious to everyone what they’re doing. Yet their size and trading volume make it difficult to hide. That’s why tracking distribution days is so important: It helps you gauge how serious the selling is and see if a true change in trend is emerging.

When the number of distribution days begins to mount, the *Market Pulse* outlook shifts from “Confirmed uptrend” to “Uptrend under pressure.” That’s a warning sign that more trouble may be on the way.

That selling may ease and fade away, allowing the market to continue its climb. But if that downward pressure picks up steam, look out!

If you get 6 distribution days within any 4- or 5-week period, the uptrend will typically roll over into a downtrend. You can see the current number of distribution days in the *Market Pulse*, and if you get enough days, the *Current Outlook* will shift to “Market in correction.”

See the following S&P 500 chart for an example of how distribution days mount, and the *Market Pulse* changes from “Confirmed uptrend” to “Uptrend under pressure” and finally to “Market in correction.”



Protect your money: Take defensive action when distribution days start to mount.

We'll see how to handle that type of weakening market in Chapter 5, “Selling Checklist.”

Feeling a Little Overwhelmed?



I don't blame you—it's a lot to take in! But don't forget: You don't have to track all of this on your own. Just check the *Market Pulse* to instantly see which way the market is currently headed.

5 Things You Need to Know About Market Cycles

1. Your Goal is to Make Money When the Market is in an Uptrend—and Protect Those Profits as a Downtrend Begins

I mentioned earlier how I learned this lesson the hard way. Like millions of other investors, I made a lot of money in the bull market of the mid- to late-1990s, but gave back much of those gains when the dot-com boom ended in 2000.

Even back then, I *knew* the stock market was “cyclical,” but I didn’t understand what impact those cycles have on *my* portfolio. I didn’t know:

- How to tell when the market trend is changing?
- What action to take when that change occurs?

Most folks don’t. And that’s not surprising since we’re constantly told that (a) you can’t time the market, and (b) “buy and hold” is the “safe” approach. *Those market myths have cost a lot of people a lot of money.*

But now you see how the market *actually* works. “Buy and hold” investors may make money in a strong market uptrend, but they’ll likely give it all back (and then some!) when a sharp downturn hits.

By using the buying and selling checklists in this book, you can unstrap yourself from that market roller coaster. Sticking to basic rules will help you generate solid profits when the market is up and lock in the bulk of those gains when the trend changes.

2. Know Where You’re at in the Market Cycle

We all know a “bull market” is when the market is moving higher, and a “bear market” means it’s trending down.

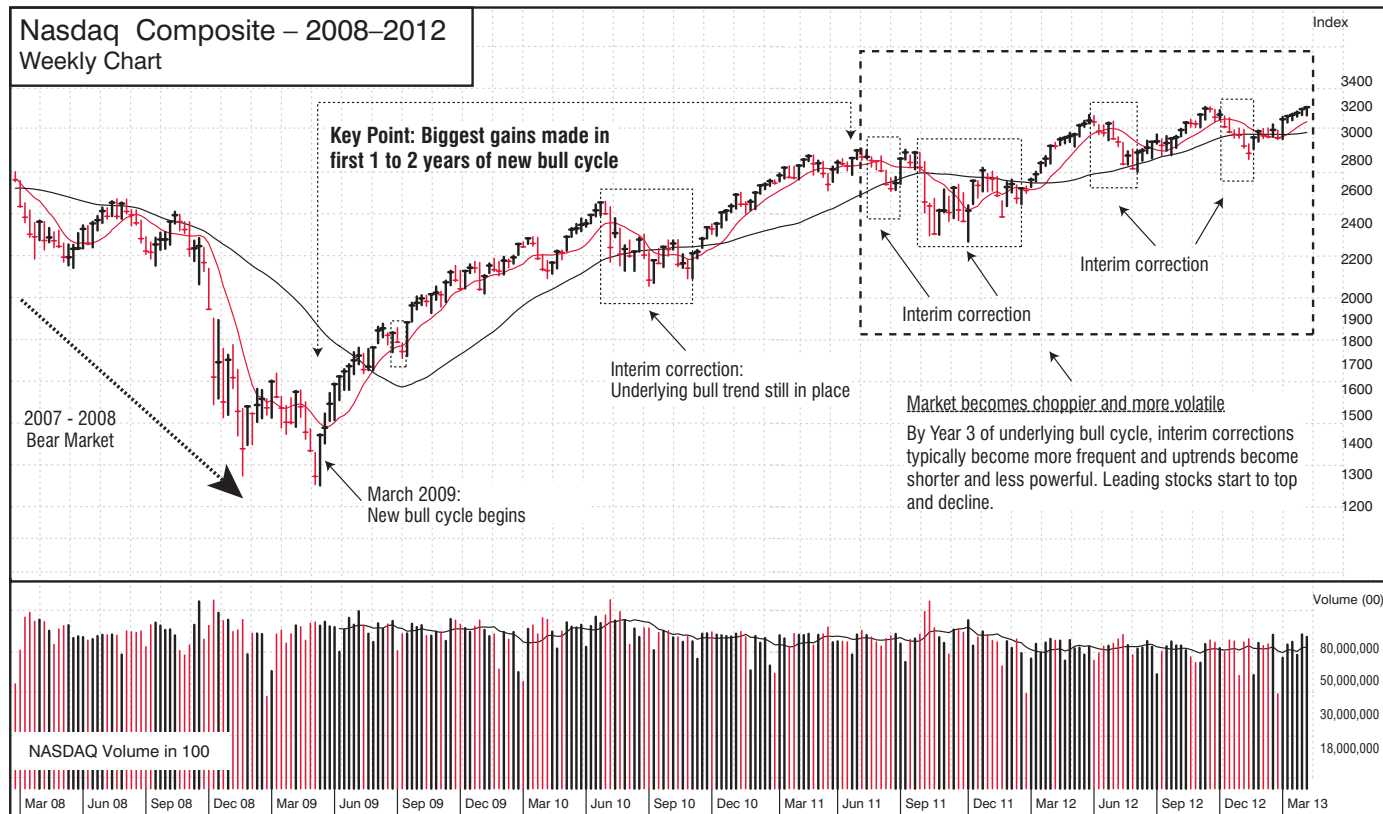
But it’s important to understand that even within a bull market, you will have what we call “interim corrections.” The major indexes will take a rest and pull back for a few weeks or a couple of months, then resume their climb. The depth of these interim corrections varies, but the Nasdaq or S&P 500 might pull back somewhere around 10% to 15%. That’s a fairly mild decline—not enough to change the underlying bull market uptrend.

As a general rule, a decline of *under 20%* indicates an interim correction. A drop of *20% or more* constitutes a bear market.

The following figure shows an example of how that works.

Nasdaq Composite – 2008–2012

Weekly Chart



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Regularly read *The Big Picture* column to know if we're in the early or later stages of the current market cycle.

How Long Do Bull and Bear Markets Typically Last?

The length varies, but here are some *general* guidelines:

- Bull markets typically last 2 to 4 years.
- Bear markets typically last 8 to 9 months.

Why Should You Pay Attention to What “Stage” the Bull Market Cycle Is In?

Because the really big gains typically happen within the first two years of a bull market.

By the time you get into the third year of a bull cycle, two things tend to happen:

- **The market becomes more choppy and volatile.** That’s a sign the bull is getting tired, and the enthusiasm found at the beginning of the cycle is starting to fade. Interim corrections may become more frequent and deep. But as long as the bull market uptrend remains in place, you may still find plenty of money-making opportunities. Just stay on your toes and stick to the buying and selling checklists since you know a bear market *will* emerge at some point.
- **Leading stocks start to peak and roll over.** As they say, nothing goes up forever. In the later stages of a bull market, institutional investors will start to cash out of the big leaders—and when they start to sell, those stocks start to drop.

When that happens, it doesn’t matter how great the company’s earnings growth and products may be, it’s time for *you* to protect your hard-earned profits. Whether it’s Apple, Google, Netflix, Chipotle Mexican Grill, or any other leading stock in any bull market, at some point you’ll need to lock in your gains—and that becomes particularly important when a bear market begins to take hold. (More on that in Chapter 5, “Selling Checklist.”)

Find Out What Stage the Market is in with *The Big Picture*



If you regularly read *The Big Picture* column, you'll always have a good sense of where we're at in the current market cycle—and what steps you should take to handle it.

3. Always Stay Engaged—Even in a Down Market

One of the biggest mistakes you can make is to stop doing your routine and ignore the market just because it's currently in a correction.

Even in a severe market downtrend, we're never more than four days away from the start of a potential new rally. That's all it takes for a follow-through day to occur and switch the *Market Pulse* outlook from "Market in correction" to "Confirmed uptrend."

And as you'll see in #5 below, if you don't keep your watch list up to date while the market is down, there's a good chance you'll miss the biggest money-making opportunities in the next uptrend.

Think of a downtrend like the off-season in baseball. You're not buying stocks right now, but if you want to have stellar results when a new "season" begins, you need to stick to your training regimen in the off-season. You never want to be out of shape on "Opening Day" when that new uptrend begins.

4. Look for *New Leaders* in a New Bull Market

In every bull market cycle, a new group of top-rated CAN SLIM stocks emerges to lead the market higher. They'll often double or triple in price in just 1 to 2 years. Some will go up even more.

They'll be the innovative leaders in whatever new inventions or industries are driving that particular bull market. In the 1990s, it was the Internet revolution and the rise of cell phones and personal computers that propelled the market higher. No surprise, then, that it was the companies driving those innovations—AOL, Qualcomm, Yahoo!, Amazon, Cisco, and others—that became the big market winners.

But here are two *other* things you need to know about leading stocks:

- When leaders eventually peak and begin to decline, they drop 72% on average.
- Only about 1 in 8 stocks that led in the prior bull market go on to lead again in the next one.

We'll get into that in more detail in Chapter 5, "Selling Checklist," but here's the point: **When a new bull market begins, don't stay focused on past winners. Look for new leaders.**

That's how you capture big gains—and you can find the *next* crop of winning stocks by regularly doing the Simple Weekend Routine, *especially* when the market is still in a correction.

5. The Big Money is Made in the *Early Stages* of a New Uptrend

Think of a market correction like a forest fire. It ain't pretty, but it's a necessary part of the cycle.

The forest fire burns down the old trees to make room for new growth. And the heat of the fire pops open the seeds so new trees can take root.

Same with the market. During a correction, most of the past leaders fall and a new crop of CAN SLIM innovators—the new growth—emerges.

But just as a new tree can't grow while the fire is still burning, a new leading stock can't shoot higher while the market is still in a correction.

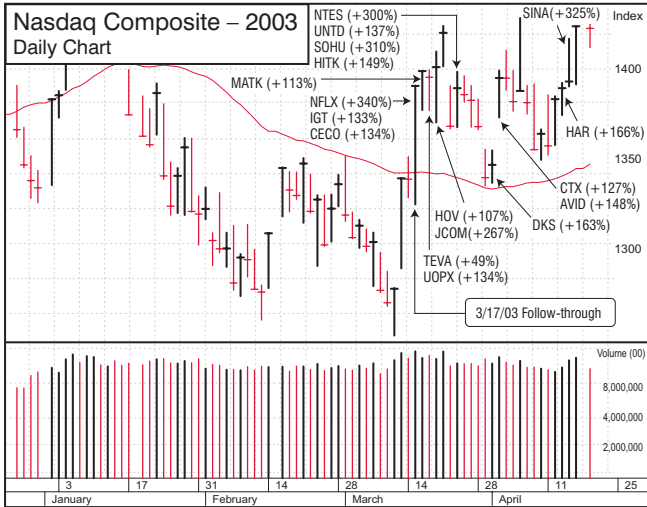
However, as soon as that market "fire" dies down and a new uptrend begins, the next crop of leaders take off. In fact, you'll find that:

Winning stocks often launch their big moves *right on* or immediately after a follow-through day.

This happens at the start of every strong new uptrend. Below are examples of how the top stocks took off right when follow-through days occurred in 2003, 2010 and 2011. As you look at the charts, note how these new leaders started their runs within days or just a couple of weeks after the *Market Pulse* shifted from "Market in correction" to "Confirmed uptrend."

Also keep this in mind: You'll typically find such stocks highlighted in the *IBD 50* and/or *Your Weekly Review* before they launch these big moves. By using the Simple Weekend Routine, you can have such stocks on your watch list as they start those big price runs.

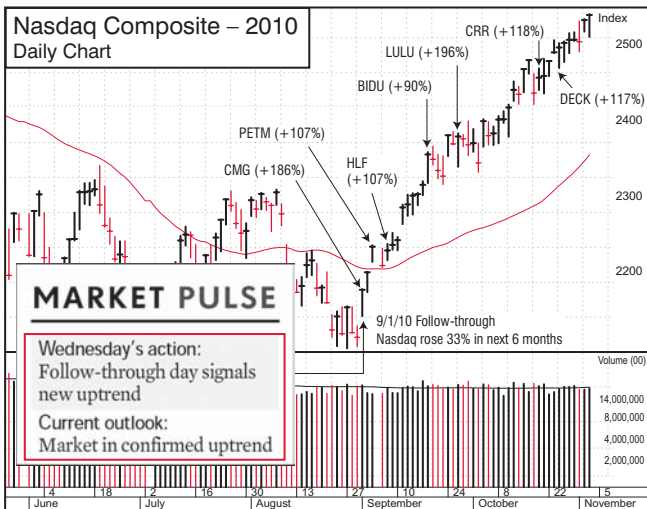
How Top Stocks Launch New Runs Right When a New Market Uptrend Begins



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AVID: Avid Technology
CECO: Career Education
CTX: Centex
DKS: Dick's Sporting Goods
HAR: Harmon Int'l Industries
HITK: Hi-Tech Pharmacal
HOV: Hovnanian Enterprises
IGT: International Game Technology
JCOM: J2 Global

MATK: Martek Biosciences
NFLX: Netflix
NTES: Netease
SINA: Sina
SOHU: Sohu.com
TEVA: Teva Pharmaceutical
UNTO: United Online
UOPX: University of Phoenix



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BIDU: Baidu
CMG: Chipotle Mexican Grill
CRR: Carbo Ceramics
DECK: Deckers Outdoor

HLF: Herbalife
LULU: Lululemon Athletica
PETM: Petsmart



See how all the market cycle pieces fit together?

- Make money in an uptrend—and protect your profits as a downtrend begins.
- Focus on “new growth”—not *past* leaders.
- Keep doing your routine and building your watch list *during* the downtrend.
- If you *don't* stay engaged while the market is down, you'll likely miss the *next* crop of big winners that shoot higher right when a new uptrend begins.

I hope this makes clear why you definitely need to understand how market cycles work—and how easy it is to stay in sync with those trends. Just check the *Market Pulse* and read *The Big Picture* regularly.

And as you'll see when we get into the Simple Weekend Routine, you can also spot the next group of potential winners by regularly checking the *IBD 50*, *Your Weekly Review*, and other lists that highlight today's CAN SLIM stocks.

The Trend Is Your Friend

It's an old cliché, but it's stuck around all these years for a reason: It's true!

You *will* build a solid foundation for making money in stocks if you simply buy when the market is trending up, and protect yourself when it starts trending down.

Everything flows from understanding market cycles and the current market direction.

In a strong uptrend, the top-rated CAN SLIM stocks will give you multiple opportunities to make significant profits. By following the rest of the Buying Checklist and the Simple Weekend Routine, you can have them on your watch list, ready to act when those opportunities arise.

Next up: Let's see what specific traits to look for as you search for the next big winners.

• ACTION STEPS •

Here are some quick *To Dos* to learn more about how market cycles work—and see which way the market is trending right now. To take these steps, visit www.investors.com/GettingStartedBook.

1. Read *The Big Picture* column in IBD or on Investors.com.
 - Is the market currently in an uptrend—or correction?
 - What else does it say about current market conditions and the action of leading stocks?
2. Watch the latest *Market Wrap* video under the *IBD TV* tab on Investors.com.

Big Rock #2: Focus on Companies with Big Earnings Growth and a New, Innovative Product or Service

Big, Accelerating Earnings Growth is the #1 Factor in Choosing a Stock

It's the primary trait that attracts fund managers and other institutional investors—the big players that provide the needed fuel for a stock's big run.

And what drives that explosive earnings growth? It's usually a game-changing product or service, new management, a major new industry trend—or some combination of all of the above.

Just think back to some of the biggest winners over the last 100+ years.

IBM: In the 1920s, IBM's high-tech punch card machines were revolutionizing how large organizations kept records. Starting in 1926, IBM soared 1,992% in 168 weeks.

Brunswick: Bowling was extremely popular in the 1950s, and Brunswick came out with a game-changing product: Automatic pin-spotters for bowling alleys. Earnings soared and the stock shot up 1,500% in 162 weeks.

Home Depot: The new “big-box store” would forever change the hardware and do-it-yourself industries. In 1982, the stock bolted 892% in 64 weeks.

AOL: In the early 1990s, cyberspace was the realm of tech-savvy geeks. Then AOL created a fun and easy way for *everyone* to go online. Starting in 1994, the stock rose 570% in just 75 weeks.

Crocs: In 2006, what caused this shoemaker's stock to soar 431% in only 59 weeks? The unmistakable “Crocs craze” created by its unique—and seemingly ubiquitous—new line of casual footwear made of a proprietary resin.

And that doesn't even mention major moves by Google, Apple, Priceline, Netflix, Baidu, F5 Networks, Intuitive Surgical, cloud computing leaders Rackspace Hosting and SolarWinds, or 3D printing innovators 3D Systems and Stratasys, just to name a few.

What did they all have in common as they made their big moves? Big earnings growth driven by a hot new product or industry trend.

Not every stock you buy will be one of these big winners, but a new crop of innovators does emerge in every new bull market cycle. They're the true market leaders that have the potential to go up 100%, 300%, 500%, or more. And since they share the same CAN SLIM® traits, you'll find them highlighted in features like the *IBD 50*, *Sector Leaders*, and *Your Weekly Review*.

Think what catching just one or two of these stocks in the *next* big uptrend could do for your portfolio.

Let's see how you can make that happen using the Buying Checklist.

Buying Checklist

Big Rock #2: Focus on companies with big earnings growth and a new, innovative product or service.

- ☐ Composite Rating of 90 or higher
- ☐ EPS Rating of 80 or higher
- ☐ EPS growth 25% or higher in recent quarters
- ☐ Accelerating earnings growth
- ☐ Average Annual EPS growth 25% or more over last 3 years
- ☐ Sales growth 25% or higher in most recent quarter
- ☐ Return on equity (ROE) of 17% or higher
- ☐ SMR® Rating (Sales + Margins + Return on Equity) of A or B
- ☐ New products, service, or management
- ☐ Among the top-rated stocks in its industry group
- ☐ Ranked in top 40–50 of IBD's 197 industry groups

IBD SmartSelect® Ratings

A big part of the Buying Checklist is making sure your stock gets passing grades for IBD SmartSelect Ratings, which show how strongly a company fits the CAN SLIM profile. You'll find these unique ratings in *Stock Checkup* on Investors.com and in the *IBD Smart NYSE + NASDAQ Tables* (Chapter 7) in the *Making Money* section of Investor's Business Daily.

It's All Relative

With the exception of the Accumulation/Distribution Rating, each rating is *relative*. In other words, they show how your stock compares to *all other* stocks on the market.

That's a huge advantage, instantly separating the leaders from the laggards.

For example, the Earnings-Per-Share (EPS) Rating goes from 1 (worst) to 99 (best). A 95 rating instantly tells you the company is outperforming 95% of all other stocks in terms of *both* current and annual earnings growth. A 99 Composite Rating means the company's overall strength puts it in the top 1% of *all* stocks.

Think how easy that is—and how much time it saves.

For example, we saw that big earnings growth is the #1 factor to look for in a stock. With one glance at the EPS Rating, you know how your stock's earnings growth stacks up against every other company on the market.

As we go through the checklist, you'll see what each rating measures and the minimum grades to look for. While you never want to buy a stock just because it has a high rating, these grades save you a tremendous amount of time by identifying stocks that do—and don't—have the CAN SLIM traits.

Unless otherwise noted below, ratings range from 1 (worst) to 99 (best).

Overall Strength



Composite Rating of 90 or higher

The Composite Rating combines all the IBD SmartSelect Ratings into one, with more weight on the EPS and Relative Strength (RS) Ratings.

A rating of 90 or higher tells you that, in terms of overall fundamental and technical strength, the stock is outperforming 90% of all other stocks.

A rating of 90 is the minimum. You'll find the true market leaders have a Composite Rating north of 95 and often have the highest-possible score of 99.

Earnings Growth

EPS Rating of 80 or higher

We saw earlier that you need to look at *Current* quarterly earnings growth (the “C” in CAN SLIM) and *Annual* earnings growth (the “A”). The EPS Rating measures *both*.

An EPS Rating of 80 tells you the company’s earnings-per-share growth is in the top 20% of all stocks. You’ll find the biggest winners often have a 95 or higher EPS Rating *prior* to launching a major move.

EPS growth 25% or more in recent quarters

As a *minimum*, you want to see earnings-per-share growth of 25% or higher in recent quarters. But you’ll often find top performers have even more impressive numbers prior to launching their big moves.

For example, in the two quarters *before* Google shot up 558% in just over three years starting in 2004, it posted EPS growth of 155% and 143%. And in 2006, shoe maker Crocs also showed two quarters of explosive earnings growth—122% and 330%—*before* its share price skyrocketed 431% in just over a year.

Accelerating earnings growth

Ideally, EPS growth should be big *and* accelerating (i.e., increasing quarter over quarter). That shows the company is continuing to grow its profits.

It’s a warning sign if a stock’s EPS growth rate starts to *decelerate* and move in the wrong direction. The stock market is forward looking, and institutional investors are looking for increasing—not declining—growth.

Case in point: As we saw in the earlier CAN SLIM case study, in the three quarters *before* Ulta Beauty surged 165% from September 2010 to July 2011, its EPS growth accelerated from 56% to 62% to 188%.

Average Annual EPS growth of 25% or more over last 3 years

A company can cut costs or take other measures to drive up its earnings per share for a quarter or two. That can mask more serious underlying problems the company may be facing in terms of demand for its products, declining profit margins, or negative industry trends.

That's why you also want to make sure the company is delivering solid *annual* EPS growth.

Here again, 25% annual growth over the last three years is the minimum. The top stocks often post numbers that dwarf that. Going back to Google in 2004, its three-year annual EPS growth rate was 293% *before* it launched its five-fold gain.

Sales Growth and Return on Equity

Does your stock have the key ingredients that drive earnings growth?

Since big, accelerating earnings growth is the #1 factor to look for, make sure the company has the basic ingredients that *generate* that type of earnings performance: **Superior sales, a high return on equity, and industry-leading profit margins.**

Sales growth shows how much demand there is for the company's products or services. Profit margins and return on equity gauge how efficiently the company is generating that sales revenue. All three factors ultimately impact a company's earnings growth.



SMR Rating of A or B

SMR Rating: Sales, Profit Margins and Return on Equity

The quickest way to see if a stock has the ingredients that drive earnings is to check the SMR Rating. It measures a company's **S**ales growth, profit **M**argins (both pre-tax and after-tax) and **R**eturn on equity. Then it compares that to the performance of all other stocks and assigns a rating from A (best) to E (worst).

An A rating means that, in terms of sales, margins and return on equity, the company is in the top 20% of all stocks.

Keep in mind, too, that the SMR Rating is a more accurate gauge than if you looked at these three factors in isolation. For example, a company could have rising sales growth but shrinking profit margins—which could have a negative impact on EPS growth down the road. By looking at the more comprehensive SMR Rating, you get the full picture.

If a stock has good earnings growth but weak sales, profit margins, and ROE, beware! That EPS growth may be less impressive—and less sustainable—than it appears.

In general, you want to buy stocks with an A or B SMR Rating and avoid those with a D or E. The next table shows why that's important.

SMR Ratings of Leaders in Q1 2012 Uptrend

These stocks broke out during a 4-month uptrend that began December 20, 2011.

Ratings are from the day of each stock's breakout.

Company	SMR Rating at <i>Start</i> of Run	Subsequent % Gain
InvenSense	A	87% in 11 weeks
Michael Kors	A	84% in 8 weeks
Monster Beverage	A	60% in 22 weeks
Sturm Ruger	A	58% in 18 weeks
Tractor Supply	A	34% in 15 weeks

 *Sales growth 25% or higher in most recent quarter*

If sales growth is less than 25%, it should at least be *accelerating* over the last three quarters.

For example, look at Netflix's sales growth just before it rocketed 683% from March 2009 to July 2011. It was under the 25% growth you prefer but was *accelerating*.

Netflix's Accelerating Sales Growth *Before* Launching 683% Run

Quarter	Sales Growth
Jun-08	11%
Sep-08	16%
Dec-08	19%

Ideally, you'd see three quarters of acceleration in both sales *and* earnings.

 *Return on equity (ROE) of 17% or higher*

Return on Equity separates the best-run companies from the also-rans.

I have to say, in my countless conversations with investors over the years, return on equity is one of the most overlooked factors. (IBD calculates ROE by dividing net income by average shareholder equity over the last two years.) But it's a critical clue to look for when picking a stock: *A strong return on equity identifies the best-run companies making the most efficient use of their capital.* Ultimately, that leads to higher profitability and earnings growth.

A 17% return on equity is the minimum benchmark, but stocks that go on to make monster moves often sport an ROE of 25%, 35% or more. The bigger, the better. The following table shows why that's true.

ROE of Leaders in 2009–2012 Bull Cycle

Company Name	ROE at Start of Big Run	Year Run Started	Subsequent % Gain
Green Mountain Coffee Roasters	21%	2009	1,104% in 30 months
Apple	27%	2009	381% in 38 months
Lululemon Athletica	30%	2010	196% in 10 months
Priceline.com	42%	2010	182% in 21 months
Herbalife	69%	2010	173% in 21 months
Chipotle Mexican Grill	19%	2010	186% in 20 months
SolarWinds	43%	2011	137% in 11 months



New products, service or management

“Out with the old, in with the new.” That could be the official mantra for the stock market, which is always looking ahead in search of companies with new, paradigm-shifting products and services.

Such leaders emerge in every bull market cycle, and here are some quick ways to see if your stock has the “N” in CAN SLIM:

- Check the company's website and press releases.
- Read IBD stories about the stock on Investors.com. Pay special attention to *The New America* section (Chapter 7), which profiles innovative companies every day.
- Learn what companies featured in IBD lists actually do. Pay particular attention to stocks highlighted in the *IBD 50* and *Sector Leaders* lists.

As we saw in the earlier CAN SLIM case study, Apple is an example of an established company that rejuvenated itself—and its stock—with new, innovative products.

More often, you'll find groundbreaking innovations in younger, entrepreneurial companies—often those that had their initial public offering (IPO) within the last 15 years, many within the last 7 to 8 years.

In every major uptrend, these game-changers emerge to lead the market's advance, driven by some product or service that's revolutionizing how we work or live.

You may have never even heard of these companies at that point. But as you search for stocks with CAN SLIM traits, they'll naturally start to appear on your radar screen.

I had never heard of Alexion Pharmaceuticals, F5 Networks, Stratasys, Lululemon Athletica, SolarWinds, Mellanox Technologies, Transdigm, or Tractor Supply until they started showing up in IBD's stock lists. But they all had something new, and that was driving exceptional earnings and sales growth. That's why they showed up early on our screens—and that's why they all made impressive price gains during the bull market that began in 2009.

Don't Ignore a Stock Just Because You've Never Heard of the Company

If it has the “N” and other CAN SLIM traits, get to know more about it: Go to their website, and read articles and profiles in IBD and other sources. You might be looking at a stock that could double or triple in price.

In 2009, not many Americans had heard of Baidu. I'm sure many still haven't.

Called the “Chinese Google,” Baidu emerged as the dominant search engine in China as millions of new Internet users came online. It was a strong new leader in a new and rapidly growing industry and rose 322% from September 2009 to April 2011. (Using the Simple Weekend Routine, you could have seen Baidu highlighted in the *IBD 50, Your Weekly Review* and other IBD features *multiple* times as it made that big move.)

New Industry Trend

The “N” in CAN SLIM can also refer to a new industry trend, which can be a boon for companies in that field, especially for the innovators driving that change.

The emergence of cloud computing is a good example. There's been a major shift away from running applications and storing data on a local computer, and instead pushing that functionality to the online “cloud.” That's meant big business—and nice share price gains—for leaders in that industry, such as Rackspace Hosting, SolarWinds, and Amazon.

That's just one example. The company names and industry trends are always changing. So regardless of what the latest technology or innovations

are when you're reading this, here's the key question to ask: *Is the stock you're reviewing benefiting from a significant new industry trend, and is it one of the companies leading that change?*

New Price High

Here's another “new” thing you should know about the best stocks: They usually start their big moves as they hit or close in on a new price high (i.e., the highest share price the stock has hit over the last 52 weeks).

We'll talk more about that when we get into charts in Chapter 6, “Don't Invest *Blindly*,” but just keep this in mind: **Stocks hitting new lows tend to go lower. Stocks hitting new highs tend to go higher.**

Translation: Don't go “bargain” hunting for beaten down stocks—chances are they'll go even lower. Instead, focus on stocks showing *strength* as they move *upward* to new price highs.

New Does Not Mean Unproven

You're not looking for companies making *promises* of a revolutionary new product or service. Those may pan out, they may not.

You're looking for companies with new products *already* on the market showing strong demand. That demand is reflected in the company's fundamentals we noted earlier: Rising sales revenue, high profit margins, and accelerating earnings growth.

Whether it's a young company making its initial public offering (IPO) or an established outfit with a new product, make it prove itself by showing CAN SLIM traits *before* you buy.

The Facebook Fiasco

Look at what happened to Facebook when it debuted in 2012. It was a new IPO in a new and growing industry—social media. And it was the dominant player in that space. So it got high marks for “new” but did not pass the rest of the Buying Checklist.

Remember how we saw that big, accelerating earnings growth is the #1 factor to look for—and that you want to see particularly strong EPS growth over the last three quarters?

Facebook showed the exact *opposite*. Just prior to its IPO, it posted three consecutive quarters of *decelerating* earnings, dropping from 83% to 17% to 9%. Sales growth was also trending down.

Facebook's Earnings and Sales Growth at Time of 2012 IPO

Quarter	Earnings	Sales
Sep-11	100%	104%
Dec-11	25%	55%
Mar-12	9%	45%

So despite all the buzz and pre-IPO hype, you could have looked objectively at Facebook and seen the bottom-line facts: Sales and earnings were *both* heading in the wrong direction. And what happened next? From its May debut through August, the stock dropped 50%.

Down the road, Facebook may have all the pieces of the puzzle in place, but if you had used this Buying Checklist, you would have clearly seen that—even prior to the IPO—the stock did not earn a passing grade. And in the company's first two reports after going public, Facebook reported 0% earnings growth.

Remember: Never buy a stock just because someone recommends it or because with all the buzz, you're "sure" it will go up. Instead, pick stocks based on *rules*: Make every stock prove itself by passing the Buying Checklist.



Among the top-rated stocks in its industry group

Here's a simple rule of thumb for successful investing: **Focus on the top-rated stocks in the top-ranked industry groups.** This part of the checklist shows if your stock fits that bill.

Stock Checkup shows the Top 5 stocks in each industry group based on IBD *SmartSelect* Ratings. In general, you want to focus on the #1 or #2 stock in the group in terms of Composite Rating.

Keep in mind: "Top-rated" does not necessarily mean "best-known."

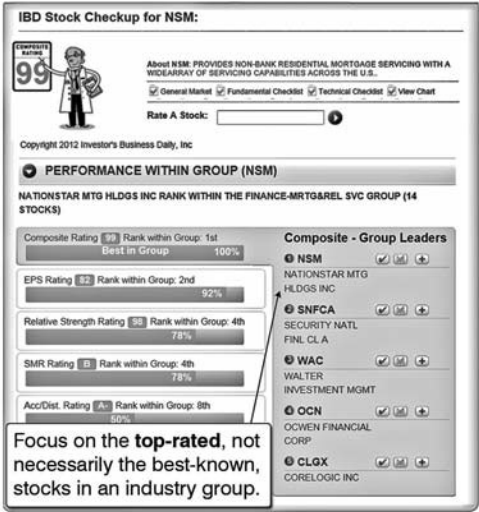
Here's an extreme example: Everyone knows mortgage giant Fannie Mae, but its stock completely collapsed during the 2008 housing crisis, and by August 2012, it had already been delisted from the Nasdaq and was trading around 25 cents a share. Yet its industry group was ranked #1 out of the 197 groups IBD tracks.

So what was the "top-rated" stock in Fannie Mae's Finance–Mortgage & Related Services group?

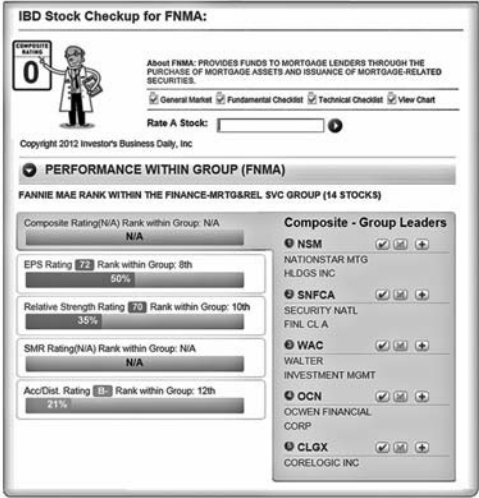
The lesser-known—but much more profitable—Nationstar Mortgage Holdings. It certainly wasn't a household name like Fannie Mae, but it had explosive earnings growth of 600% and 999% in the two quarters since going public in March 2012. And from May to August 2012, Nationstar's stock jumped 88% in just 14 weeks.

Is Your Stock a Leader Within its Industry Group?

Nationstar Mortgage vs. Fannie Mae



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Nationstar Mortgage's "Best in Group" ranking and 99 Composite Rating showed it was the true industry group leader.

✓ Ranked in top 40–50 of IBD’s 197 industry groups

As IBD founder Bill O’Neil has said, “You cannot overstate the importance of being aware of new group movements.”

Almost half of a stock’s price move depends on the strength of its industry group and sector:

Sector = 12%

Industry group = 37%

Total = 49%

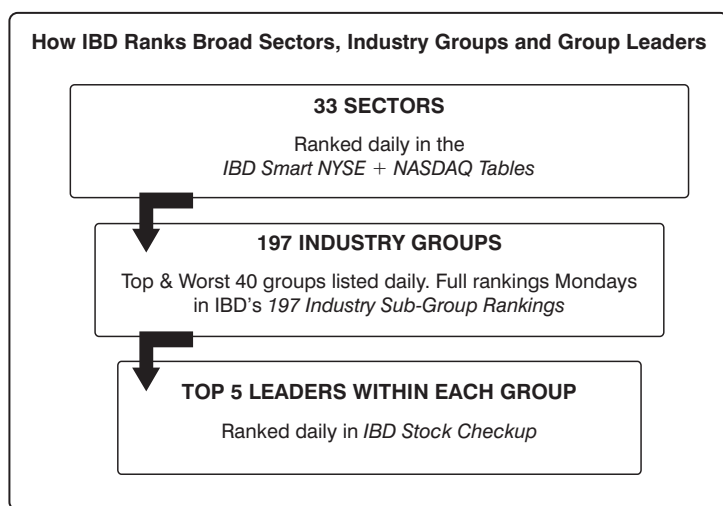
That means your stock has a better chance of moving up if its *industry* shows strength. Here’s why.

As we’ll see in detail later, it’s the buying and selling power of institutional investors that ultimately pushes the general market and individual stocks up or down.

So when they shift their money into a certain sector or industry group, that sector or group will move up in the rankings. You want to follow their lead and put your money into the same industries. (And on the flip side, when a sector or industry group starts to *sink* in the rankings, beware! Get ready to take defensive action since the stocks within that industry will likely decline as big investors sell their shares and move that money somewhere else.)

How to Track Sectors → Industry Groups → Group Leaders

You can see where institutional investors are putting their money by regularly checking IBD’s rankings for 33 sectors and 197 industry groups. Then, as we saw earlier, you can see which particular companies are the leaders within each group by checking the five top-rated stocks in *Stock Checkup*. The following graph outlines how that works.



We start with sectors, dividing all stocks into broad categories like Retail, Building, Computers, Energy and Medical. Those 33 sectors are then ranked daily based on the price performance of the stocks within each sector.

That's an important first step, but it doesn't tell you the whole story. To more clearly pinpoint where institutional investors are putting their money, check the industry group rankings.

IBD's 197 industry groups break down the broad sectors into smaller factions made up of stocks that are closely aligned in terms of the specific business they're in.

This is crucial because, for example, Retail may be the #1 sector, but which specific groups are leading that growth? Which groups are lagging?

There are 18 different industry groups within the Retail sector, including Consumer Electronics, Discount & Variety, Internet, Leisure Products, and Restaurants. You want to know which ones are showing the most strength and moving up in the rankings—because you want to see where institutional investors are putting their money.

Rise of the Discounters

Here's just one example of why checking industry group rankings is an important part of your stock-picking process . . .

In February and March 2010, the Retail sector was consistently among the top five sectors. Within that sector, the Retail–Discount & Variety indus-

try group was moving sharply higher in the rankings: In mid-March, the group was ranked #25 out of the 197 groups, up from #176 seven months earlier.

Remember: At that time, the economy was struggling. People on tight budgets do more shopping at discount stores, and that's why institutional investors began shifting their money into stocks in the Discount & Variety industry group.

So it's no coincidence that around the same time, top-rated stocks within that group started impressive runs: Those moves were being fueled by the institutional money moving into that industry.

Dollar General 124% gain in 29 months

Dollar Tree 225% gain in 30 months

By checking the rankings, you would have seen that another group in the Retail sector, Retail–Apparel/Shoes/Accessories, had also been moving up rapidly. As of February 24, 2010, the group had jumped from #117 to #19 over the last seven months.

Two leaders in that group also happened to be discount retailers: Ross Stores and TJX Companies, which owns T. J. Maxx and Marshalls. That further confirmed the big institutional money was flowing into operators of bargain stores. Both TJX and Ross broke out within a week and generated solid gains for investors over the next two years:

Ross Stores 176% gain in 29 months

TJX Companies 125% gain in 30 months

Coincidence? Not at all. Year after year, countless examples reinforce this simple strategy: **Focus on the top-rated stocks in the top-ranked industry groups.**

Why put yourself at a disadvantage by buying low-rated stocks in a low-ranked group?

Where to Find Industry Group Rankings

You can see the current ranking for your stock's group in *Stock Checkup*.

Pay particular attention to stocks in the top 40 groups, and avoid those in the bottom 40.

You'll find the top 40 and worst 40 groups each day in the print and digital editions of IBD. The full list of *IBD's 197 Industry Sub-Group Rankings* is published every Monday. (Note: "Sub-group" and "group" are used interchangeably.)

Top 40 Groups (6 mos.)										Worst 40 Groups (6 mos.)									
Day's best bolded, worst underlined. Full Group List in Monday's issue.																			
Rank		3		6	Industry	Group		Days		Rank		3		6	Industry	Group		Days	
This	Wks	Wks	Wks	Wks		Composite	YTD	%	Chg	This	Wks	Wks	Wks	Wks		Composite	YTD	%	Chg
Wk	Ago	Ago	Ago	Ago	Name	Rating	%Chg.	%		Wk	Ago	Ago	Ago	Ago	Name	Rating	%Chg.	%	
1	1	88	EnergySolar	..	+4.1	-2.8				158	159	161	CmpSftwr-Spc-Entr	66	+2.9	-5.3			
2	8	18	Media-Radio/Tv	..	+31.6	+0.5				159	151	151	Cinematic/Digital Cn	64	+7.1	+0.4			
3	28	48	Medical-Hospitals	90	+15.5	-1.7				160	160	160							-0.3
4	2	2	Mchnry-Mtl Hdlg	89	+7.9	+1.1				161	161	161							+0.7
5	67	65	Leisre-Mvies&Rel	90	+19.3	+0.8				162	162	162							-0.5
6	3	1	Fin-Mrtg&Rel Svc	90	+4.2	-0.1				163	163	163							+1.9
7	4	3	Bldg-Cment/Cnctr	87	+9.8	+2.0				164	164	164							-0.9
8	19	9	Bldg-Rsidnt/Comm	90	+12.4	+1.3				165	161	142	Utility-WaterSupply	67	+4.1	+1.1			
9	10	4	Bldg-Cnstr Prds/Msc	86	+8.7	+0.9				166	185	163	Retail-Spr/Mini Mkts	61	+6.3	+0.4			
10	9	15	Comm Svcs-Stffng	90	+7.7	-0.2				167	166	161	Banks-Midwest	51	+4.5	+0.5			
11	17	17	MetalPrds-Distribtr	..	+7.6	+1.8				168	181	193	ComptrSftwr-Mdcl	78	+11.5	+0.1			
12	5	16	Mchnry-Cnstr/Mng	78	+7.9	+0.3				169	167	166	Financ-Pbl Inv Fdeqt	..	+6.9	+0.2			
13	54	37	Rtail Whlsle Offc Sup	..	+12.5	+0.4				170	160	168	Leisre-Trvl Bking	..	+11.9	-0.5			
14	12	8	Comm Svcs-Leasing	91	+9.5	+0.1				171	158	115	Retail-Dprtmnt Strs	..	+2.2	+1.3			
15	7	5	Chemicals-Plastics	88	+6.7	-0.9				172	176	160	Soap & Cng Preparat	..	+4.7	+0.7			
16	27	14	Oil&Gas-Rfing/Mkt	78	+12.7	+2.3				173	168	134	Energy Coal	36	+5.2	+0.7			
17	6	6	Auto/Trck-Rplc Prts	..	+4.9	-1.1				174	193	179	Retail/Wsl-Auto Prt	..	+3.8	-1.2			
18	21	30	Fin-Invest Bnk/Bkrs	87	+10.5	+0.8				175	179	152	Food-Confectionery	..	+8.0	+0.3			
19	24	87	Trnsprttn-Airline	91	+8.2	0.0				176	172	158	Medical-Generc Drgs	61	+0.6	-0.1			
20	11	26	Banks-Money Cntr	83	+6.2	+0.8				177	186	175	Retail-Specialty	73	+2.6	-0.4			

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You can also see if the group's ranking has been moving up or down. The list shows current ranking and where the group stood 3 and 6 weeks ago.

3 Key Points

We've gone through a lot of details, so let's take step back for a minute and look at the 3 main takeaways from this chapter:

- Focus on companies with big earnings growth and a game-changing new product or service.
- Fish where the fish are: Look for the top-rated stocks in the top-ranked industry groups.
- Use *Stock Checkup* to quickly see if your stock passes or fails this part of the checklist.

Check out the Action Steps below to start using the Buying Checklist and make sure these key points really sink in.

And remember: You can find today's top-rated CAN SLIM stocks by doing the Simple Weekend Routine (Chapter 4).

Next up: Let's see if institutional investors are heavily buying—or selling—your stock.

• ACTION STEPS •

Here are some quick *To Dos* to reinforce the stock-picking skills we've learned so far. To take these steps and start using the Buying Checklist, visit www.investors.com/GettingStartedBook.

1. See how to go through the checklist with a short video: *Does Your Stock Pass or Fail? Find Out with Stock Checkup*.
2. Check IBD's industry group rankings to see which groups are in the Top 40 right now.
 - Rankings are found in the *Making Money* section of Investor's Business Daily each day.
3. Find out what's "new" and innovative about today's *Sector Leaders*.
 - See which stocks are on the *Sector Leaders* list (Chapter 7) in the *Making Money* section of IBD, then read IBD articles about them.
 - Read the *Smart Table Review* column, which covers the latest action of the sector leaders. You'll find it on Investors.com and in the *Making Money* section of IBD.

Big Rock #3: Buy Stocks Being Heavily Bought by Institutional Investors. Avoid Those They're Heavily Selling.

For a stock to go up 50%, 100% or more, *someone* has to keep buying shares at a continually higher price to fuel that move. And they have to buy a *lot* of shares—hundreds of thousands, even millions. Only *institutional* investors—primarily mutual fund managers—have that kind of buying power.

So if you want to find stocks with the potential to double or triple in price, focus on those being bought heavily by these professional investors. It's not a guarantee of success, but *without* that fuel, a stock won't be able to make a sustained upward move.

And when those same institutional investors start to sell, look out! That high-volume selling pressure will likely push the share price sharply lower. Fighting that deluge is like trying to swim up a waterfall. You're essentially guaranteed to get pummeled. So move to the sidelines and wait for big investors to start buying the stock again. You'll find it's much easier to swim *with* the current than *against* it. (More on that in Chapter 5, "Selling Checklist," and Chapter 6, "Don't Invest *Blindly*.")

Yes, You *Can* See What Big Investors Are Up To

In some ways, the massive buying power of institutional investors gives them an advantage. But there is a downside for them—and an upside for you and me: *They're too big to hide what they're doing.*

The best way to literally *see* what they're up to is to use stock charts. If you've never used charts before, I think you'll be amazed at the "behind-the-scenes stories" they reveal—how they lift the curtain to show you if fund managers are heavily buying or selling a stock, or if they're just sitting tight and quietly scooping up a few more shares.

I personally find it fascinating that a few simple lines on a graph can tell you so much about what's really going on. But they can—and you'll find that once you know what to look for, it's really not that hard to do. In fact, in many cases, you'll find the story is actually hard to *miss*. You'll see telltale patterns stocks form just before they launch a big move and early warning signs that tell you it may be time to lock in your gains.

We'll get into charts and what they reveal about the trading of institutional investors in Chapter 6, "Don't Invest *Blindly*." (Feel free to jump ahead to that if you're curious.)

For now, let's focus on some other quick ways you can see what the all-important fund managers and other institutions are up to.

Buying Checklist

Big Rock #3: Buy stocks being heavily bought by institutional investors.

Avoid those they're heavily selling.

- ☐ Increase in number of funds that own the stock in recent quarters
- ☐ Accumulation/Distribution Rating of A or B
- ☐ Relative Strength Rating of 80 or higher
- ☐ Share price above \$15
- ☐ Average daily volume of 400,000 shares or more

Get Pass or Fail Ratings for Each Item



You can instantly see if your stock gets a pass, neutral or fail rating for each item in this section of the checklist using *Stock Checkup* on Investors.com. If you're near a computer, take a look at the ratings in *Stock Checkup* as we go through the descriptions below.



Increase in number of funds that own the stock in recent quarters

To confirm that your stock is in demand by institutional investors, make sure the number of funds that own the stock rose in the most recent quarter. Ideally, the number of funds should be rising over the last 3 or 4 quarters.

Also, look for a *material increase* in the number of funds in the most recent quarter.

If that number is *not* increasing—or worse, if it's *decreasing*—what does that tell you?

It could indicate a lack of enthusiasm for the stock among fund managers. Until they start getting in, that stock will probably not go up in any meaningful way.

How Do You Know if Fund Ownership Is Rising or Dropping?

In *Stock Checkup*, you'll find a pass, neutral or fail grade for your stock's institutional sponsorship. You'll also see how many quarters of rising fund ownership the stock has.

✓ IBD® Stock Checklist

Supply and Demand		
Market Capitalization	3.70 B	●
Acc/Dis Rating	C+	●
Up/Down Volume	1.3	●
% Change in Funds Owning Stock	18%	●
Qtrs of Increasing Fund Ownership	3	●

Pass

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Don't Be the First to Arrive at the Party!

There are many misconceptions about how the stock market actually works. One is that you have to get into a stock before the big investors do. In fact, the *opposite* is true: The best stocks have *rising* institutional sponsorship *before* they soar.

The mutual fund managers at Fidelity, Vanguard, Janus, Dreyfus, CGM, and elsewhere all have teams of researchers who dig into the current performance and future prospects of thousands of publicly traded companies.

If a stock is *not* owned by a significant number of funds (say, 50 or more), it means that at least some of the 10,000 institutional investors out there have studied the stock and decided to take a pass.

That's *not* a cause for celebration, thinking you've somehow stumbled upon a hidden gem. It's a cause for *concern*.

To see why you won't be late if you wait for funds to start getting in, you need to understand that it can take these big institutions weeks, even months, to establish their positions in a stock.

For example, if the manager of a \$2 billion fund decides he or she wants to put 1% of the fund's capital into a certain stock, that manager has to buy a \$20 million position. If the stock trades around \$20 a share, that fund manager has to buy 1 million shares.

If the manager tried to buy all those shares in one go, it would quickly drive up the price of the stock beyond the price he or she wanted to pay. So instead, over a few weeks or months, the fund's traders will quietly buy shares in smaller increments until they've established the desired \$20 million position around the average cost-per-share they were targeting.

And that's just *one* fund. If dozens, hundreds, or even thousands of funds are moving in to the same stock, do the math! By the time Apple topped in 2012, it was owned by over 4,300 funds.

That doesn't happen overnight. It can take many months of continued buying before all these professional investors establish their positions.

That gives you time to get in and ride their coattails.

Good Gains Come to Those Who Wait for Confirmation

The table below shows how it pays to be patient and make sure the number of funds with a position in the stock is rising before you jump in.

Examples of Rising Fund Ownership *Before* a Big Run

Company	Starting Year of Run	# of Funds Owning Stock in 4 Quarters Prior to Price Move	Subsequent % Gain
Green Mountain Coffee Roasters	2009	148 → 187 → 201 → 227	1104% in 30 months
Watson Pharmaceuticals	2009	606 → 586 → 619 → 669	154% in 26 months
Netflix	2009	300 → 375 → 395 → 436	683% in 28 months
Ulta Beauty	2010	149 → 149 → 152 → 169	165% in 11 months
Chipotle Mexican Grill	2010	327 → 360 → 436 → 463	186% in 19 months

In the table above, look at the four quarters of fund ownership for Watson Pharmaceuticals and Ulta Beauty. In the first two quarters, the number of funds that owned Watson Pharmaceuticals actually dropped, and for Ulta Beauty that number stayed flat. But in the most recent quarter just *before* both stocks launched their big runs, note how the number of funds jumped significantly higher. That's the kind of "material increase" you want to see. It shows institutional investors are moving in and picking up shares.



Accumulation/Distribution Rating of A or B

Here's another way to see if institutional investors are buying or selling your stock: Check the Accumulation/Distribution Rating (ACC/DIS RTG®).

Accumulation is a fancy word for buying. Distribution refers to selling. The Acc/Dis Rating, which ranges from A (best) to E (worst), tracks *institutional* trading in a stock over the last 13 weeks (roughly three months). It does that by focusing exclusively on the large-volume trades only professional investors make.

The table below shows what the A to E ratings mean. In general, only buy stocks with an A or B Accumulation/Distribution Rating, and avoid those rated D or E.

Accumulation/Distribution Rating

Measures the level of buying and selling by *institutional investors* in a stock over the last 13 weeks

- A = Heavy buying
- B = Moderate buying
- C = Equal amount of buying and selling
- D = Moderate selling
- E = Heavy selling

The info below for Netflix shows the kinds of gains that are possible when a stock passes the institutional sponsorship criteria and other areas of the Buying Checklist.

Netflix's Institutional Sponsorship Just *Before* Rising 683%

March 2009–July 2011

Accumulation/Distribution Rating at time of breakout: A–

Fund ownership in 4 quarters *prior* to big move: 300 → 375 → 395 → 436



Relative Strength Rating of 80 or higher

You're not looking for just *good* stocks. You're looking for the *best* ones—those that are clearly outperforming the rest of the pack. The Relative Strength (RS) Rating is yet one more way to separate the cream from the rest of the crop.

The RS Rating tracks a stock's share price performance over the last 52 weeks and compares it to that of the S&P 500, which is often used as a bellwether for the general market. To see how that compares to every other stock, a rating from 1 (worst) to 99 (best) is given.

An RS Rating of 80 means the stock's share price performance is outpacing 80% of all other stocks.

Look for a Strong Relative Strength and EPS Rating

The RS Rating focuses on the strength of the *stock* as valued by the market (i.e., the “technical”). The EPS Rating gauges the strength of the *company* (i.e., the “fundamentals”).

Think of it as the yin and yang of investing: By insisting that your stock has strong ratings for *both*, you're looking at the whole picture, not just half of it.

As Bill O'Neil has said, if you look at the stocks that have made enormous runs over the last several decades, **“The vast majority of superior stocks will rank 80 or higher on both the EPS and the RS ratings before their major moves.”** And 80 is the *minimum*. The top stocks often rate much higher for both EPS and RS.

85-85: A Profitable Combination

The IBD® 85-85 Index tracks the performance of stocks that score 85 or higher for both the EPS and RS Ratings. These are the stocks included in IBD's *Your Weekly Review*.

While hindsight is 20-20, you could say *foresight* is 85-85: From inception on November 13, 2000, through February 5, 2013, the IBD 85-85 Index rose 275% compared to the S&P 500's 12% gain. While that does not mean every stock with 85 or higher EPS and RS ratings will make a big run, it does show how this powerful combination of solid earnings growth and relative price strength can lead to substantial profits—and why you want to focus your research on stocks with similar ratings.

 Share price above \$15

We're all human. It can be tempting to chase low-priced stocks, thinking they offer the most potential for a big gain. But they're usually cheap for a reason: Weak (or nonexistent) earnings growth, lackluster sales, or a lack of new and exciting products. Because of that, they have a hard time attracting institutional investors, and we've already seen how important it is to have rising institutional sponsorship.

So the two takeaways here are:

1. Avoid cheap, low-priced stocks.
2. Don't be afraid to buy seemingly "high-priced" stocks with a share price of \$50, \$100 or more.

Focus on the CAN SLIM traits, not the "high" share price.

When Priceline *started* a 182% run in 2010, it was already trading around \$270 per share. And Apple may have *seemed* expensive when its share price hit \$150 in July 2009. But less than three years later, it had climbed to \$644.

Not all CAN SLIM stocks have triple-digit share prices. SolarWinds launched its 137% move in 2011 from a share price around \$25. The prices for these three stocks were different, but their winning profiles were the same: They had the CAN SLIM characteristics.

By definition, CAN SLIM stocks are the fastest-growing, most profitable companies on the market. Just as you can't buy a Mercedes for the price of a Chevy, CAN SLIM leaders tend to command a higher share price and a higher P/E ratio than inferior stocks (Chapter 2).

So focus on the CAN SLIM traits . . . don't chase cheap stocks . . . and if all the other checklist items are in place, don't worry if the share price *seems* high.

 Average daily volume of 400,000 shares or more

"Volume" refers to the amount of shares a stock trades in a given period (e.g., in a day or week). Stocks that have a *low* average daily volume are said to be "thinly" traded.

You want to avoid thinly traded stocks for the same reason you want to steer clear of low-priced ones: Institutional investors tend to avoid them, so you should too. Plus they tend to be more volatile.

The average daily volume varies widely and can change over time for the same stock. At the time of this writing, Google, for example, is trading around 2.5 million shares on average every day, while Fleetcor Technologies is trading much less, around 670,000.

Mutual fund managers tend to establish large positions, buying tens of thousands or even millions of shares. That's hard to do in a stock that only trades 50,000 shares a day. It's easier to establish a meaningful position—without driving up the price too quickly—in a stock that trades a few *million* shares on average.

Also, when it comes time to sell, it's easier for institutional investors to unload their shares in a “liquid” stock—one that has a big pool of buyers and sellers and trades in large volume. It's much harder for fund managers to quickly get out of thinly traded stocks: Their own high-volume selling can quickly drive down the price, which either reduces their profits or increases their losses.

Keep in mind that while any stock can be subject to a sudden price swing, thinly traded stocks tend to be more volatile. It takes much less volume to significantly impact the price of a stock that trades 50,000 shares a day than one that trades 3 *million*.

So focus on stocks that trade *at least* 400,000 shares per day. A more conservative investor trying to reduce the risk of volatility might look for stocks trading 1 million shares or more each day. One place to find such stocks is the *IBD Big Cap 20* (Chapter 7).

Funds Will Determine the Fate of *Your* Stocks

By now you understand that mutual funds and other institutional investors account for the bulk of all trading, and therefore they ultimately determine the fate of a stock. If they're heavily buying, the stock will go up. If they're heavily selling, the stock will go down.

It's the same for the overall market. New uptrends begin when these big investors start buying aggressively and end when they start to sell.

People can talk about all kinds of fancy technical indicators and throw around exotic Wall Street lingo, but that's the bottom line. And that's why it's critical you make sure (a) the market is in an uptrend, and (b) your stock passes this section—and the “Chart Analysis” segment—of the Buying Checklist before you invest.

It's not that hard to do, and that little extra effort will go a long way to generating superior profits.

Next up: Let's compare two potential CAN SLIM stocks using the criteria on the Buying Checklist.

• ACTION STEPS •

Here are some quick *To Dos* to start using the Buying Checklist and reinforce what we've covered so far. To take these steps, visit www.investors.com/GettingStartedBook.

1. Run 2 to 3 stocks through the Buying Checklist. As practice, you can skip the "Chart Analysis" section for now, but *don't buy a stock without first checking the chart*. We'll cover chart-reading in Chapter 6, "Don't Invest *Blindly*."
- **Check market direction:** Use the *Market Pulse* in *The Big Picture* column to see if we're currently in an uptrend or correction.
- **Review potential CAN SLIM® stocks:** If you don't have a stock in mind, choose one from the *IBD 50*, *Your Weekly Review*, *Sector Leaders*, or *Stock Spotlight* (Chapter 7).
2. See how to go through the checklist with a short video: *Does Your Stock Pass or Fail? Find Out with Stock Checkup*.

A Tale of 2 Stocks: Priceline.com vs. Expedia

In July 2009, we were just a few months into a new bull market that began in March. As you were searching for stocks to buy, you might have come across two big players in the online travel booking business, Priceline.com and Expedia.

As we saw in the checklist, you want to pay particular attention to the top-rated stocks in the top-ranked industry groups. In July, the Leisure–Travel Booking group (known as Leisure–Services at the time) was ranked #11.

With that in mind, let's look at the key *facts* known about Priceline and Expedia at the time.

As you go through this, consider what you now know about what to look for in a stock *before* you buy, and ask yourself:

- Which company looks stronger?
- Which stock has a higher likelihood of making a big price gain?
- Which one would you choose to invest your hard-earned money in?

Think about how each company stacks up against the “big rocks” we've been discussing.

All data as of July 2009

Does the Company Have Big Earnings Growth?

Earnings-Per-Share (EPS) Growth in Prior 3 Quarters

Quarter	Priceline.com EPS Growth	Expedia EPS Growth
Sep-08	51%	–31%
Dec-08	34%	–13%
Mar-09	43%	–5%

While Expedia has shown *negative* earnings growth the last 3 quarters, Priceline's EPS growth has been above the 25% minimum and accelerated in the most recent quarter.

Avg. Annual Earnings Growth over Last 3 Years

Priceline.com	Expedia
74%	8%

Priceline’s *annual* earnings growth is over 9 times better than Expedia’s, which gets a failing grade because it’s well below the 25% benchmark.

EPS Rating	
Priceline.com	Expedia
99	63

The highest-possible 99 EPS Rating shows Priceline is outperforming 99% of *all* stocks in terms of recent quarterly and annual earnings growth. Expedia scores a mediocre 63, which is under the minimum 80 rating we look for in the Buying Checklist.

SMR Rating	
Priceline.com	Expedia
A	B

Return on Equity	
Priceline.com	Expedia
44%	10%

While Expedia’s SMR Rating of B earns a passing grade, Priceline’s score is even better. That shows Priceline has superior performance in the 3 main ingredients that drive EPS growth: **S**ales, **P**rofit **M**argins and **R**eturn on Equity. And Priceline’s ROE is over 4 times stronger than Expedia’s 10%, which again fails to meet the 17% minimum.

Always keep in mind: Big earnings growth is the #1 factor to look for in a stock. And at this point in time, Priceline’s growth was clearly outpacing that of Expedia.

Does the Company Have a New, Innovative Product or Service?

Priceline’s innovative and exclusive “Name Your Own Price” system had already been in place for years, but was still a major—and unique—draw for consumers. They also had several “new” things driving growth, including kitschy commercials featuring William Shatner.

To increase sales, Priceline had earlier dropped its booking fees. Competitors—including Expedia—didn’t take similar action until 2 years later.

Priceline was also rapidly expanding in a new market—Europe—with its recent acquisition of Booking.com. That marked a new and growing opportunity, since European travelers were still just starting to go online to book their hotels and airfare.

Expedia's main “new” change was to its service policies and fees—done primarily in reaction to steps Priceline had taken earlier. It hoped to attract more travelers by eliminating cancellation fees for hotels, car rentals, cruises and most airline tickets.

Are Mutual Funds Heavily Buying the Stock?

Accumulation/Distribution Rating

Priceline.com	Expedia
A	B

No. of Funds Owning Stock in Prior 4 Quarters

Quarter	Priceline.com	Expedia
Sep-08	654	761
Dec-08	632	727
Mar-09	716	740
Jun-09	773	795

With an Accumulation/Distribution Rating of B and rising fund ownership, Expedia clears the institutional sponsorship criteria in the Buying Checklist. But here again, Priceline's institutional demand is even stronger: It is actually being *more* heavily bought by fund managers.

What Is the Stock's Overall Strength?

Composite Rating

Priceline.com	Expedia
99	95

Expedia's 95 Composite Rating was strong, showing it was in the top 5% of all stocks. But you're looking for the best of the best, the true market leaders. And Priceline's 99 Composite Rating meant it was in the top 1%.

What About the P/E Ratio?

Price/Earnings (P/E) Ratio	
Priceline.com	Expedia
21	18

In Chapter 2, we already discussed why P/E ratios are *not* an important factor when it comes to deciding what stocks to buy. In fact, investors who only buy stocks with low P/E ratios and never buy ones with so-called “high” P/Es will miss out on virtually *every* big winner.

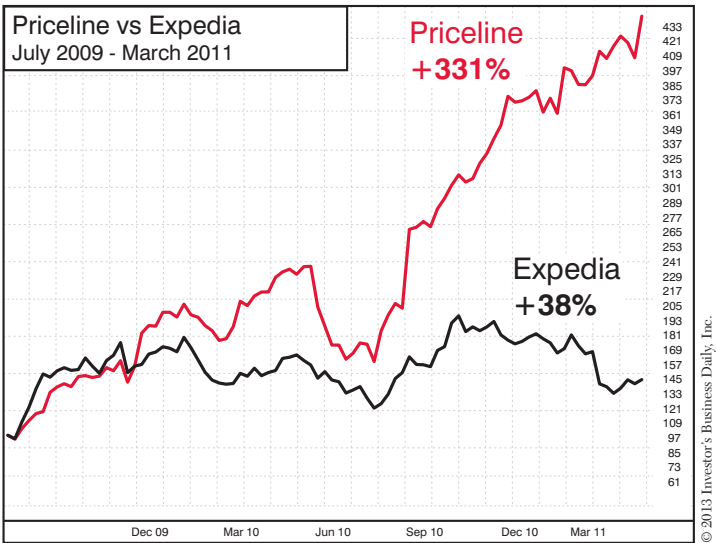
So ask yourself: After seeing everything else we just covered about these two companies, would you buy Expedia just because it had a lower P/E ratio?

What Happened Next?

Do you see how it quickly becomes obvious which stock is stronger as you go through the checklist? No guesswork—just the *facts*. And the more you do it, the quicker and easier it gets.

The difference in the gains that followed proves the payoff for using the Buying Checklist can be life-changing.

Subsequent Gains for Priceline.com and Expedia



Next up: Now it's your turn to review 2 stocks and decide which one has more potential.

You Make the Call: Which Stock Looks Stronger?

Now it's *your* turn to choose.

Below are the actual earnings, ratings, institutional sponsorship and other vital facts about two companies in the same industry group. Based on what we've covered so far, compare the two and ask yourself: *Which stock looks stronger?*

At the end, I'll reveal the names of the two companies and what happened next to their stocks.

Does the Company Have Big Earnings Growth?

Earnings-Per-Share (EPS) Growth in Prior 3 Quarters

Quarter	Company A EPS Growth	Company B EPS Growth
Dec	47%	-38%
Mar	86%	-3%
Jun	75%	20%

Avg. Annual Earnings Growth over Last 3 Years

Company A	Company B
48%	1%

EPS Rating

Company A	Company B
93	30

SMR Rating

Company A	Company B
A	C

Does the Company Have a New, Innovative Product or Service?

Company A	Company B
New products have made it a leading player in two industries.	Major player in its industry, but no game-changing innovations in recent years.

Are Mutual Funds Heavily Buying the Stock?

Accumulation/Distribution Rating		
Company A	Company B	
B+	C	

No. of Funds Owning Stock in Prior 4 Quarters		
Quarter	Company A	Company B
Sep	2956	1765
Dec	3097	1806
Mar	3247	1776
Jun	3512	1808

Time to choose: Which company looks stronger, A or B?

Apple vs. Dell July 2009

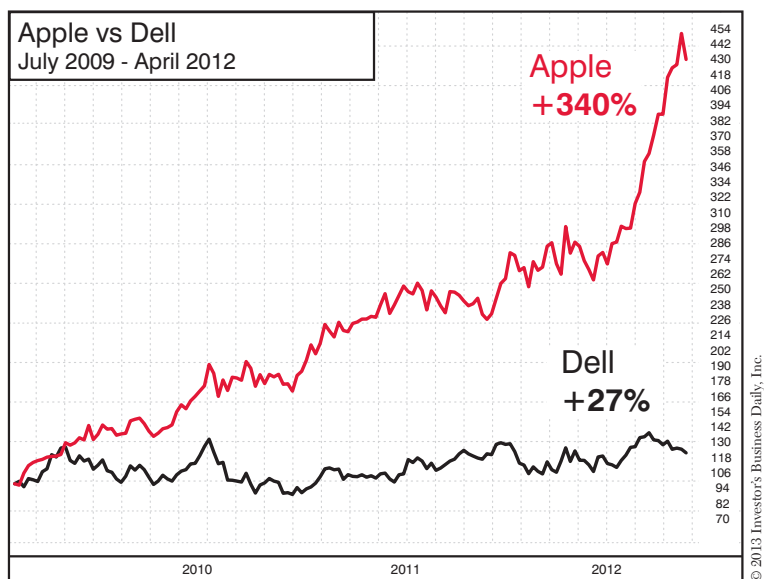
The checklist results clearly show **Apple (Company A)** was demonstrating much more strength than **Dell (Company B)**.

The return of founder Steve Jobs in 1997 spurred a phenomenal period of innovation for Apple. The iPod®, iTunes®, iPhone® and the “app” ecosystem were revolutionizing the music and smartphone industries, leading to the explosive earnings growth you saw above.

Dell had been following a different trajectory. While still a major player in the computer industry, Dell’s growth had slowed dramatically compared to the 1990s. Founder Michael Dell’s return as CEO in 2005 failed to rejuvenate the company in the way Jobs’s return had for Apple.

What Happened Next?

Subsequent Gains for Apple and Dell



Look at the huge difference in those gains. *That’s* why you want to put your money into stocks that have CAN SLIM® traits.

When you’re screening stocks, your choices won’t always be that clear-cut. But 100+ years of market history make the most essential point *very* clear.

To find the best stocks—the ones most likely to make a huge price gain—look for stocks that:

- Have big earnings growth and new, innovative products
- Are top-rated leaders in a top-ranked industry group
- Are being heavily bought by institutional investors

When you focus on stocks that pass the Buying Checklist by displaying those traits—and make sure the overall market is in a solid uptrend—that's a time-tested recipe for making money in stocks.

Next up: What do you do if your stock gets a mix of pass *and* fail marks on the Buying Checklist?

What if Your Stock Gets Both Pass *and* Fail Ratings?

This will certainly happen. Investing, after all, is not an exact science. Few stocks—even those that go on to stellar gains—are picture perfect in every single respect.

So here are tips on how to handle stocks that have a few blemishes.

- **If the stock fails in *several* areas, take a pass and move on.**

You're not looking for mediocre stocks. You're looking for the market's strongest leaders. These top stocks may have one, two or maybe three flaws, but they won't have a lot of serious ones. So if a stock fails on several items on the Buying Checklist, keep your powder dry and keep looking.

As T. Boone Pickens has said, "If you're going to hunt elephants, don't get off the trail for a rabbit."

- **Focus on the "big rocks"—the most important factors in deciding *what* to buy.**

- Does the stock have big earnings growth and a new, innovative product or service?
- Are mutual funds heavily buying the stock?

Always put those big rocks in first. A stock may come up short on a checklist item or two, but make sure you can answer a definite "yes" to those two key questions above.

Let's look at a few "mixed bag" scenarios you're likely to encounter.

Scenario 1: Strong Stock but Relatively Weak Industry Group

If you find a stock that passes everything on the checklist, *except* its industry group is *not* ranked in the top 40–50 groups, should you toss it by the way-side? Not necessarily.

Yes, you want to focus on the top-rated stocks within the top-ranked industry groups. But there are times when a big winner will emerge from a somewhat lower-ranked group.

One example is Ulta Beauty. As we saw in the case study for Ulta (see Chapter 2), it had explosive earnings growth; it had a popular new retail concept that was revolutionizing how cosmetics were sold; and mutual funds were heavily buying its stock.

But when it launched its 165% run, Ulta Beauty's Retail–Specialty industry group was only ranked #82.

The group ranking is important because a higher ranking means funds and other institutional investors are moving into that industry. So if you do invest in a stock that is *not* in a top 40–50 group, make sure the stock gets flying colors for the other checklist items. You also need to make sure mutual funds are heavily buying the stock to at least partially make up for the *lower* group ranking. That was the case for Ulta: In the 4 quarters before its big move, the number of funds that owned shares jumped from 197 to 315.

Also, if the group ranking is sub-par, make sure there is at least one *other* top-rated stock in the group. That confirms institutions are showing some interest in the industry. You had that for Ulta Beauty: Fellow retailer Sally Beauty Holdings sported a solid 95 Composite Rating and launched a big run around the same time as Ulta.

Scenario 2: Drop in Fund Ownership in Most Recent Quarter but Strong Accumulation/Distribution Rating

Let's say you were running Lululemon Athletica through this checklist in September 2010.

Did it have big earnings growth? Yes, its EPS growth in the prior 3 quarters accelerated from 43% to 100% to 180%. It also had a very strong 30% return on equity.

Did it have a new, innovative product or service? Yes, again. It had found a profitable niche with high-end yoga apparel as the popularity of yoga was rising.

Were mutual funds heavily buying the stock? Yes, but with some caveats.

In the first quarter of 2010, the number of funds that owned Lululemon jumped from 189 to 223. But in Q2, it *dropped* to 206. As we saw in the “Big Rock #3” section of the checklist, you'd prefer to see that number rise in the most recent quarter.

But there were mitigating factors that made up for that flaw. One was that even with that drop, the number of funds that owned shares was up over the last 4 quarters, from 195 to 206.

Also, when Lululemon launched its big move, it had an Accumulation/Distribution Rating of B+, indicating moderate to heavy buying by institutional investors over the last 13 weeks. And just a few days before it launched its big move, it released its latest earnings report and professional investors poured in, driving a spike in trading volume that was over 600% higher than normal.

So while Lululemon did have a flaw or two, it was strong overall, and it had the three most important elements we look for: Big earnings; a new, innovative product or service; and mutual funds were heavily buying shares.

From that point, it shot up 196% in just 10 months. (By the way, over the next 4 quarters, the number of funds that owned Lululemon jumped from 205 to 359.)

Scenario 3: Strong but Not Accelerating Earnings Growth

In September 2010, Chipotle Mexican Grill was a CAN SLIM® leader, but it had a flaw: Its EPS growth had *decelerated* over the last 3 quarters, from 90% to 53% to 33%. Obviously, you'd prefer to see that going in the opposite direction.

But again, when you ask the most important questions, Chipotle got a “yes” in response to each one.

Did it have a new, innovative product or service? Chipotle's chain of organic gourmet burrito restaurants was extremely popular and well-positioned to serve the growing number of people who wanted a healthier alternative to typical fast food fare.

Were mutual funds heavily buying the stock? Yes. Just before it broke out, Chipotle had a solid Accumulation/Distribution Rating of B, and the number of funds that owned shares had risen sharply over the last 4 quarters.

Did it have big earnings growth? Since Chipotle's EPS growth had decelerated in recent quarters, were there any mitigating factors that could garner a positive answer to this key question?

One was that, while deceleration is certainly not ideal, Chipotle's earnings growth was still above the 25% minimum we look for.

Also, its *annual* earnings growth over the last 3 years was 38%—well above the 25% minimum benchmark.

Chipotle's EPS Rating was 97, meaning in terms of overall current and annual earnings growth, it was outpacing 97% of all stocks. Plus, it had a solid return on equity of 19% and the highest possible Composite Rating of

99, meaning it was in the top 1% of all stocks in terms of overall strength—including current and annual earnings growth.

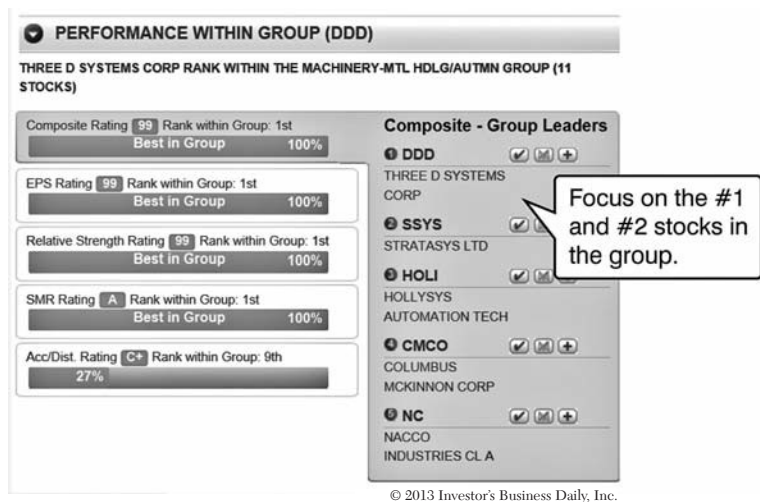
So while not picture perfect, Chipotle—like Lululemon—showed market-leading power, and it went on to gain 186% over the next 20 months.

Don't Let the “Perfect” Become the Enemy of the “Very Good”

If you come across a stock that gets a passing grade for almost all the items on this checklist but misses on one or two, don't automatically write it off. Look at the big picture, and see if it has the most critical things to look for: Big earnings growth, a hot new product or service, and clear demand from fund managers.

What if Your Stock Doesn't Pass?

Check the Group Leaders in IBD Stock Checkup



If the company you're looking at doesn't pass the checklist, try this: Check the top-rated stocks in the same industry group, found at the top of *Stock Checkup* (see the example above).

Focus primarily on the #1 and #2 stocks, and run them through the same checklist. It's a great way to discover the true industry leaders and build a quality watch list.

Be Cautious—but on the Hunt— During Earnings Season

Four times a year, publicly traded companies report their earnings and sales figures for the prior quarter. The latest numbers can pleasantly surprise—or bitterly disappoint—professional analysts and investors. That’s why you often see dramatic swings—up or down—when a company reports.

So during earnings season, you often see a lot of breakouts, but you may also see several *breakdowns*.

Because you don’t know which way that pendulum will swing, **don’t buy a stock just before it releases its latest earnings report.**

Instead, wait for the stock to announce the numbers, and see how the market reacts. If the stock shoots past a proper buy point on heavy volume, that could offer a chance to get in. If it sells off on massive volume, you’ll be glad you didn’t try to “guess” and jump in early.

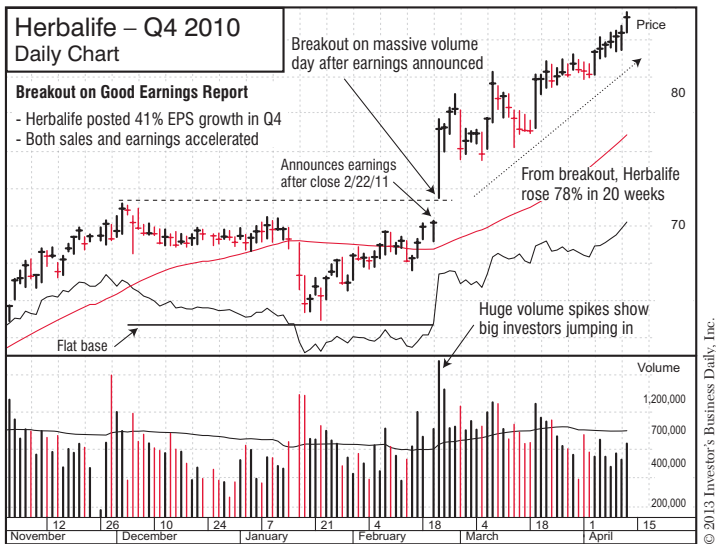
Here are 3 simple tips on how to handle earnings season:

- **Check to see when any stock you own or have on your watch list is scheduled to report.** You can find that information on the company’s website or through other services. During earnings season, IBD publishes the *Earnings Calendar*, a list of key stocks scheduled to report the following week. You’ll find that in the Monday edition.
- **Have your buying and selling game plans in place *ahead of time*.** If you’re considering buying a stock that could potentially break out of a base when it reports earnings, know the exact buy point you’re looking for and how many shares you’ll purchase. If you own a stock that’s about to report, be sure to have a defensive selling plan in place, just in case it suddenly sells off.
- **Consider using automatic trade triggers.** If you can’t watch the market during the day, set a trade trigger with your broker ahead of time (see Chapter 4). You can set a conditional buy order for a stock on your watch list to make sure you catch it if it breaks out while you’re away from your computer. And you can set a stop-loss order to help protect your profits or cap any losses if a stock you already own declines.

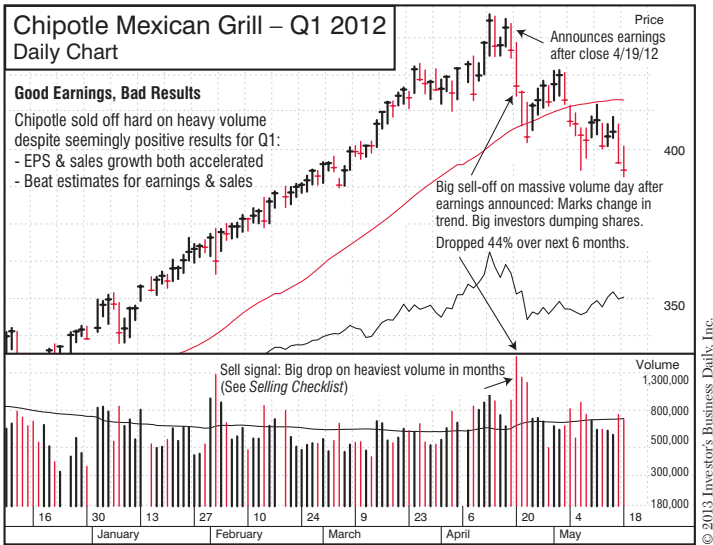
Expect the Unexpected

Earnings season can sometimes leave you scratching your head. A stock may soar higher on a seemingly weak quarterly report, while another may sell off despite posting stellar numbers. Again, that's why your best bet is to wait for the company to report and see how the market reacts.

Below are examples of two very different reactions to two seemingly positive earnings announcements. They're good reminders of how you can keep the odds of success in your favor by keeping your powder dry until you see how the company's earnings story plays out.



Herbalife soared 78% in 20 weeks after reporting accelerating earnings growth.



Despite posting accelerating earnings and sales growth, Chipotle sold off.

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Simple Routines for Finding Winning Stocks

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Want Good Results? Stick to a Good Routine!

*“We are what we repeatedly do.
Excellence, therefore, is not an act but a habit.”*

—ARISTOTLE

It’s impossible for me to overemphasize how important it is to have a routine that:

1. Helps you identify the best stocks *before* they surge.
2. Fits *your* schedule.

Both elements are crucial. You could have the greatest routine known to Wall Street, but if you don’t have time to use it *regularly*, what good does it do you?

That’s why these routines are designed for busy people with limited time to invest.

Maybe you work during the day. Maybe you’re retired. Either way, I’m sure you have family, hobbies and other interests *outside* of the stock market—those things we commonly refer to as “life”!

So here are two routines designed to be quick and easy for *anyone* to use:

- **Simple Weekend Routine:** This uses two of IBD’s most powerful screens to identify stocks that have CAN SLIM® traits and are near a potential buy point right now.
- **10-Minute Daily Routine:** Keeps you on top of the market throughout the week and makes sure your watch list and game plan stay up to date.

Think of the Simple Weekend Routine as your core prep time. It’s where you update your watch list and make your game plan so you’re ready for the week ahead. Once that’s in place, use the 10-Minute Daily Routine to refresh and execute your plan as needed.

Understand that these are just two sample routines to get you started. As you become more familiar and comfortable with CAN SLIM investing and Investor’s Business Daily, you might come up with your own routine.

More Routines by Successful CAN SLIM Investors



You can learn about the investing routines of other CAN SLIM investors by reading my radio show co-host Amy Smith's book, *How to Make Money in Stocks—Success Stories*. I think you'll agree it's a very inspiring and informative read.

Have a Selling Plan in Place *Before* You Buy

I encourage you to jump right in and start using these routines, but with one important caveat: *Don't buy any stocks until you've gone through the Selling Checklist chapter*. Buying stocks without having a selling game plan is like driving a car with no brakes—very exciting at first, not so pleasant at the end!

So be sure to go through the Selling Checklist and understand basic sell rules before you invest.

Always Stick to Your Routine—Even in a Market Downtrend

I'm repeating this point because it's *extremely* important: One of the biggest mistakes you can make is to walk away and stop doing your routine just because the market is currently in a correction. That's how you *miss* the next big winners.

The best stocks form bases during a market correction then shoot out of the gate right when a new uptrend begins.

If you want to catch the *next* crop of leaders—and cash in on the big profits they deliver—keep doing your routine even when (in fact, especially when) the *Market Pulse* says “Market in correction.”

Snooze, You Lose—Stay Awake, You Rake (In the Profits)

To see mini case studies of why it's so important—and profitable—to always stay engaged with the market, see “Finding Winners Using the Simple Weekend Routine” later in this chapter.

Have You Started Your Free Trial of IBD?



To start your free trial and get access to the tools in these routines, visit www.investors.com/GettingStartedBook. You'll also find short videos that walk you through each step of the daily and weekend routines.

Simple Weekend Routine



20–30 Minutes

Step 1: Check overall market direction in *The Big Picture*.



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Don't ignore this step—it's critical. Most stocks move in the same direction as the overall market, either up or down.

So as we noted earlier: **Only buy stocks when the *Current Outlook* says "Confirmed uptrend."**

I *strongly* encourage you to read *The Big Picture* regularly. It gives invaluable insight into what's happening in the market—and how to handle it.

When & Where to Find It

The Big Picture is found daily in the *Making Money* section of IBD and on Investors.com.

Step 2: Look for stocks near a buy point by quickly scanning the *IBD 50* and *Your Weekly Review*.



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Look at the one-line analysis below the chart for each stock. Circle or make note of any stocks said to be nearing or in a potential buying range.

When & Where to Find It

The *IBD 50* is updated every Monday and Wednesday in the *Making Money* section of IBD and *eIBD*.

(The Monday print edition is delivered on Saturdays in most areas so you have it in time for your weekend routine.)

Your Weekly Review is published every Friday in the A section of IBD.

Step 3: Use IBD Stock Checkup to see if the stocks you circled pass the Buying Checklist.

IBD Stock Checkup for DDD:

ABOUT DDD: MANUFACTURES PRINTING, PROTOTYPING AND MANUFACTURING SYSTEMS TO PRODUCE 3-D OBJECTS FROM COMPUTER DATA

☒ General Market ☒ Fundamental Checklist ☒ Technical Checklist ☒ View Chart

Rate A Stock: 1

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PERFORMANCE WITHIN GROUP (DDD)

THREE D SYSTEMS CORP RANK WITHIN THE MACHINERY-MTL, HDLG/AUTNM GROUP (11 STOCKS)

Composite Rating: 99	Rank within Group: 1st
Best in Group: 100%	
EPS Rating: 98	Rank within Group: 1st
Best in Group: 100%	
Relative Strength Rating: 99	Rank within Group: 1st
Best in Group: 100%	
SMR Rating: A	Rank within Group: 1st
Best in Group: 100%	
Acc/Dis. Rating: B	Rank within Group: 5th
63%	

SMR - Group Leaders

- DDD** Three D Systems Corp. ☒ ☒ ☒
- SSYS** Stratusys Ltd. ☒ ☒ ☒
- HOLI** Hollysys Automation Tech. ☒ ☒ ☒
- CASC** Cascade Corp. ☒ ☒ ☒
- HURC** Hurco Companies Inc. ☒ ☒ ☒

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In *Stock Checkup*, you'll find pass, neutral or fail ratings for most items on the checklist.

And if you're not familiar with the company and what it does, check out its website and read what IBD and others have written about it. You'll find links to articles in *Stock Checkup*.

You may also find the stock was recently covered in a *Daily Stock Analysis* or *Market Wrap* video on Investors.com.

When & Where to Find It

Stock Checkup is available on Investors.com and updated daily.

Step 4: Add the strongest stocks to your watch list.

My Stock Lists

Show: Near Buy Point (Default)

with: SmartSelect

New | Export | Import | Print | Modify >

Symbol	Company Name	Composite Rating	EPS Rating	RS Rating	SMR Rating	Acc/Dis Rating	Group Rel Str Rating	IBD Tools
DDD	Three D Systems Corp	99	98	99	A	B	A+	☒ ☒ ☒
GMCR	Green Mtn Coffee Roasters	98	99	98	A	A+	B+	☒ ☒ ☒
CELG	Celgene Corp	98	98	92	A	A+	A	☒ ☒ ☒
CVLT	Commvault Systems Inc	97	98	90	A	B+	C+	☒ ☒ ☒
FLT	Fleetcor Technologies	97	98	95	A	B+	C+	☒ ☒ ☒
SODA	Sodastream Intl Ltd	99	98	91	A	A-	A	☒ ☒ ☒
FNGN	Financial Engines Inc	99	97	94	A	A	A-	☒ ☒ ☒
MIDD	Middleby Corp	99	93	93	A	A	A	☒ ☒ ☒

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Make a game plan for each stock that has passed the Buying Checklist and is near a potential buy point:

- What is the ideal buying range? (Chapter 6)
- How many shares will you buy if it breaks out?

Watch to see if any stocks on your list break out in the coming days and weeks. (Make sure each stock still passes the Buying Checklist and the market is in an uptrend at the time of the breakout.)

You can also set up automatic trade triggers with your broker ahead of time (see “Busy During the Day? Set Automatic Trade Triggers” later in this chapter).

Also see “How to Build and Maintain an Actionable Watch List” (Chapter 7).

Tune in to IBD’s Weekly Radio Show



Join Amy Smith and me each week for a look at the current market and how to use CAN SLIM® rules to handle it. For details on how to tune in, visit www.investors.com/radioshow.

• ACTION STEPS •

Time to jump in and try out the routine for yourself! To see how, visit www.investors.com/GettingStartedBook.

- 1.** Watch a short video on how to do the Simple Weekend Routine.
- 2.** Use the routine to see what potential big winners you find. (Remember: Don’t invest until you also go through Chapter 5, “Selling Checklist,” and set up a selling game plan.)

10-Minute Daily Routine



10 Minutes

Step 1: Check overall market direction with *The Big Picture*.

MARKET PULSE

Friday's action:
Up in lower volume

Current outlook:
Confirmed uptrend

Distribution days:
4 for Nasdaq and NYSE
composite, 3 for S&P 500

Leaders up in volume:
Google^{GOOG} ARM^{ARMH}
Eastman Chemical^{EMN}
Celgene^{CELG} NeuStar^{NSR}
Tupperware^{TUP} Cree^{CREE}
SodaStream^{SODA}
Thermo Fisher^{TMO}
Icici Bank^{IBN} Expedia^{EXPE}
CommVault^{CVLT}

Leaders down in volume:
Priceline.com^{PCLN}
Alkermes^{ALKS} PVH^{PVH}

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Scan *The Big Picture* for answers to these questions:

- Any changes in market direction (e.g., from correction to uptrend)?
- Which leading stocks are moving up in big volume?
- What trends are emerging—and how should you handle them?

You can also watch the *Market Wrap* video for a 3–4 minute overview of the day's action and highlights of selected leading stocks.

When & Where to Find It

The Big Picture is found daily in the *Making Money* section of IBD and on Investors.com.

The *Market Wrap* video is found daily at Investors.com/IBDtv.

Step 2: Review stocks you own or have on your watch list.



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Pull up a chart to see how your stocks are faring:

- Any buy or sell signals in the stocks you own?
- Have stocks on your watch list broken out or broken down?

You can also do a search for your stocks on Investors.com to see if IBD wrote about them recently.

If you take a minute to *regularly* check your stocks, you'll become much better at spotting any changes in trend. The more you do it, the faster—and more profitable—it gets.

When & Where to Find It

Use *Stock Checkup* and *IBD Charts* on Investors.com.

Step 3: As your schedule allows, look for new stock ideas.

The screenshot shows the 'IBD Stock Research Tool' interface. It has tabs for 'MARKET DIRECTION', 'FIND STOCKS', 'EVALUATE STOCKS', and 'TRACK STOCKS'. Under 'FIND STOCKS', there's a dropdown menu set to 'Stocks on the Move' and buttons for 'Add to My Routine' and 'Watch Video'. Below this, a text box states: 'Stocks being BOUGHT heavily by institutional investors. Click icons for analysis. Learn More'. The main table lists five stocks with columns for Symbol, Company, Price, Price Chg., Price % Chg., Volume % Chg., and IBD Tools. At the bottom, it says 'Expand View All' and 'Real time prices by BATS. Volume delayed. Last Update: 02/07/2013 11:50 AM EST'.

Symbol	Company	Price	Price Chg.	Price % Chg.	Volume % Chg.	IBD Tools
GEOS	Geospace Technologies	109.65	15.83↑	16.87%↑	665%	[Icons]
RRTS	Roadrunner Trans Systems	21.29	1.49↑	7.53%↑	371%	[Icons]
MMS	Maximus Inc	72.23	3.70↑	5.40%↑	320%	[Icons]
BPOP	Popular Inc	28.06	0.94↑	3.47%↑	303%	[Icons]
LOPE	Grand Canyon Education	25.18	0.82↑	3.37%↑	270%	[Icons]

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You'll probably do most of your research on the weekend, but if you have time during the week, here are some other places to find timely stock ideas:

- *Sector Leaders*
- *Stock Spotlight*
- *Stocks on the Move™*
- *Daily Stock Analysis* video

See Chapter 7, "More Tips and Tools for Getting Started Right," for how to use these and other features to find winning stocks.

Step 4: Adjust your game plan and watch list as needed.

Based on what you find in Steps 2 and 3, add or remove stocks from your watch list, and adjust your buying or selling game plan as needed.

Remember: You can set up automatic trade triggers with your broker ahead of time.

Good Results Start with a *Regular* Routine!

The key to spotting big winners *early* is to have a *regular* routine. Whether you use these routines or something better fitted to your schedule or investing style doesn't matter. What's crucial is that you come up with a plan that works for you and stick to it.

As motivational speaker Brian Tracy has said, “**Successful people are simply those with successful habits.**”

• ACTION STEPS •

Time to jump in and try out the routine for yourself! To see how, visit www.investors.com/GettingStartedBook.

- 1.** Watch a short video on how to do the 10-Minute Daily Routine.
- 2.** Start using this routine to stay on top of any stocks you own and build your watch list. (Remember: Don't invest until you also go through Chapter 5, “Selling Checklist,” and set up a selling game plan.)

Busy During the Day? Set Automatic Trade Triggers

If you work during the day and can't watch the market, you can set "conditional orders" ahead of time with your broker.

It can be a great way to catch a big breakout—even as you're plugging away at your day job. And when you're on vacation and can't watch your stocks closely, you also can set conditional sell orders to lock in your gains or cut short any losses if the stock declines.

Important: Talk with your broker before placing a conditional order for the first time. Certain brokers have different ways of setting up these types of trades.

For example, some allow you to set them up based on both price *and* volume, so you can make sure institutional investors are buying heavily as the stock breaks out.

So before you start using trade triggers, call your brokerage service, tell them what your objective for the order is, and have them walk you through the various offerings they have to meet your needs.

Here are some basic examples.

Buy Stop Orders

Purpose: To buy a stock as it breaks out from a proper buy point

Use a buy stop order when you want to buy a stock, but only after it climbs higher and hits a certain price.

Let's say you find a stock on the *IBD 50* that passes the Buying Checklist and is near a potential buy point of \$30. But right now, it's trading at \$29.50.

On Saturday or Sunday, after you've done your research and set your game plan using the Simple Weekend Routine, you could log in to your online broker's website and set a buy stop order for \$30.

If a few days or weeks later the stock hits the target \$30 share price, your trade will get triggered automatically. (You can set an expiration date for your conditional order: If it doesn't get triggered within that time frame, the order is cancelled.)

Check the Volume!

If your broker doesn't let you use conditional orders that track both price and volume, be sure to check the volume after your trade has been triggered. You want to see a nice spike in the number of shares traded when a stock breaks out. That confirms institutional investors are buying aggressively. (More on that in Chapter 6, "Don't Invest *Blindly*.")

Stop-Loss Orders

Purpose: To automatically cut short any losses

We've already touched on the cardinal rule of selling: Always sell if a stock drops 7% to 8% below what you paid for it. You can use stop-loss orders to make sure you stick to that rule, and it's very easy to do.

Let's say you bought a stock at \$100 a share. If you set a stop-loss order at \$93 (i.e., a 7% loss), then the stock will be automatically sold at the market price if it slips to that target.

If you have a hard time selling—if you're afraid you might "freeze" when it's time to get out—having a stop-loss order in place can put your mind at ease.

Trailing Stop-Loss Orders

Purpose: To lock in the bulk of your profits if a stock starts to decline

Trailing stop-loss orders can be very useful but also a little tricky, since there are several different versions. So call your brokerage service and have them show you the right way to set them up.

Here's just one way you can use a trailing stop-loss.

Let's say you bought a stock at \$100, and it's now trading at \$150. Congrats—you're sitting on a nice 50% gain!

The last thing you want to do is let those profits disappear, so you could set up a trailing stop-loss order to make sure you automatically lock in a good portion of your gains if the stock starts to head south.

Let's say you set a trailing stop of 10%. (You can choose a percentage or dollar amount.)

If the stock drops 10% below the current \$150, the sell order would be triggered, and you'd lock in the remaining profits. (Still a nice gain of 35%.)

But let's say the stock *doesn't* decline 10% and instead shoots up to \$200—giving you a 100% gain.

Your 10% trailing stop-loss order would be *automatically* adjusted to that new current market price. Pretty convenient, right?

So now if the stock *did* start to decline and dropped 10% below the \$200 mark, your sell order would get triggered—locking in the bulk of that big gain.

Use Conditional Orders Wisely

Using automatic trade triggers can be a great way to make sure you don't miss out on a big breakout—and safeguard your profits if a stock begins to drop.

Just make sure you use them correctly. Talk with your broker about how to set them up, and be sure to watch the market as often as you can. Conditional orders are definitely convenient and a big help to busy investors, but remember: There's no substitute for staying engaged and keeping a close eye on your stocks.

Finding Winners Using the Simple Weekend Routine

Here are just a few examples to give you a sense of the kind of big gains you can capture using the Simple Weekend Routine as your starting point.

Keep in mind: Big winners like the ones below emerge in every strong uptrend, and you can find them if you just *regularly* follow that basic game plan.

Green Mountain Coffee Roasters (GMCR)

Here's a day-by-day look at how you could have found Green Mountain Coffee Roasters *before* it broke out and soared over 1,000% from March 2009 to September 2011. The information below is what you would have found if you were doing the routine on the weekend of March 13–15, 2009.

Step 1: Check overall market direction with *The Big Picture*.

THE BIG PICTURE
NYSE Indexes Follow Through; Financials Again Lead

BY JONAH KERI
INVESTOR'S BUSINESS DAILY

The NYSE indexes followed through on a new rally, as more good news from financials and the other sectors fueled big gains in higher volume Thursday.

The S&P 500 vaulted 4.1%, the NYSE composite and Nasdaq 4%, the Dow industrials 3.5%. Volume climbed 2% on the NYSE and 11% on the Nasdaq compared with Wednesday's levels.

The big advance in higher volume marked a follow-through day for the S&P 500, NYSE composite and Dow on the fifth day of their rally attempts.

The Nasdaq's surge came on the third day of its rally attempt – a bit early when compared with the model of follow-throughs.

The market has now notched three straight up days, with two of those huge price moves in higher volume. That's a stark change in behavior after the raft of losses that had swamped the market since mid-February.

Still, that doesn't mean growth investors should dive back into the market too quickly, or too aggressively.

Several follow-throughs over the past few months have gone nowhere. Each time, the market was unable to sustain gains. Last month, indexes undercut their November lows.

Also, a market goes far with leading stock stocks have been almost broken.

But come Monday, starts yielding you'll have profit with week. Leading stock following relation Tuesday. The 100 index – Your Weekly Page A5, inch with strong, sizable buy point. Good news if such as Citigroup helped lift this week, as reported a just months of 2008 crash said the Mountainville, Electric's CEO.

MARKET PULSE
Thursdays action: NYSE stocks follow through on new rally

Current outlook: Market in confirmed rally

Leaders up in volume:
Cubic^{CLB} CardioNet^{BEAT}
NVE Corp.^{NVEC}
Neutral Tandem^{TNDM}
Teva Pharmaceuticals^{TEVA}
American Italian Pasta^{APIC}
American Science & Engineering^{ASEI}

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On March 12, 2009, the *Market Pulse* outlook changed from “Market in correction” to “Confirmed uptrend” (called a “rally” at the time).

That told you a new uptrend was just beginning, following the 2008 bear market.

Follow the market, not the news!

Despite investor fears and bad economic news after the housing and financial crisis, the market action showed it was time to buy.

Step 2: Look for stocks near a buy point by quickly scanning the IBD 50 and Your Weekly Review.



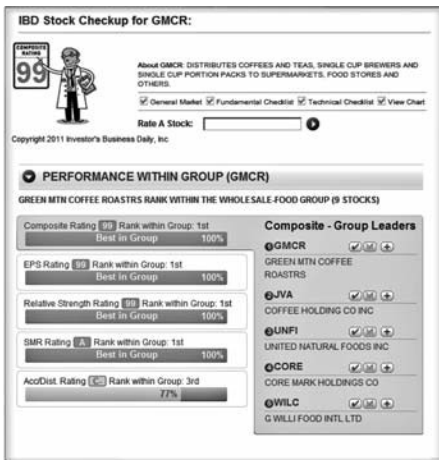
The same day the market direction changed to “Confirmed uptrend,” the analysis for Green Mountain Coffee Roasters in *Your Weekly Review* said: “Cup with handle appears with buy point at 42.99.”

Green Mountain was also featured in that day’s *Daily Stock Analysis* video.

With the general market in an uptrend and Green Mountain near a potential buying area, it definitely merited further review.

New to charts? Note how *Your Weekly Review* identified the chart pattern and buy point. That’s a huge help if you’re new to chart-reading.

Step 3: Use IBD Stock Checkup to see if the stocks you circled pass the Buying Checklist.



A quick look at *Stock Checkup* showed Green Mountain passed the Buying Checklist:

- Composite Rating: 99
- EPS Rating: 93
- RS Rating: 97
- Return on Equity: 21%
- Last Quarter Sales Growth: 56%
- Last Quarter EPS Growth: 14%*
- 3-Year Annual EPS Growth: 43%

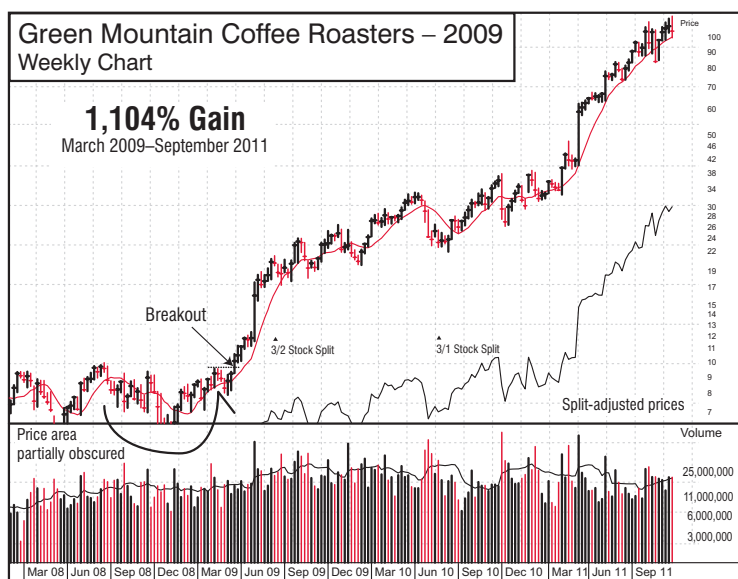
*Green Mountain's earnings growth slipped to 14% in the most recent quarter, but annual EPS growth was 43%, and the previous quarter's gain was 76%.

Plus, it had the “N” in CAN SLIM®: An innovative new product—single-serving K-Cup gourmet coffees—that was revolutionizing the industry.

Step 4: Add the strongest stocks to your watch list.

Over the weekend, you could have added Green Mountain to your watch list, with a game plan to buy if it broke past the 42.99 buy point. And you could have set a trade trigger with your broker before the market reopened on Monday.

You would have been glad you did: On Monday, March 16, 2009, Green Mountain Coffee Roasters broke out and ran up more than 1,000% over the next 2½ years.



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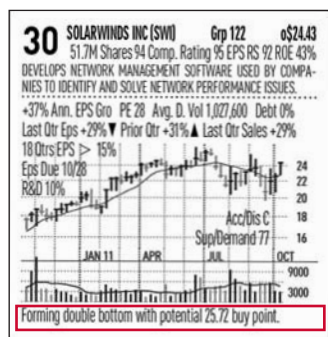
Green Mountain Coffee Roasters is just one example of why it pays to do the Simple Weekend Routine regularly.

What if You Missed the First Breakout?

Don't fret. The *IBD 50* and *Your Weekly Review* highlighted Green Mountain as being near a potential buy point **over 20 more times** during its 1,000%+ gain.

Never give up—and keep doing the Simple Weekend Routine. The best stocks will give you *multiple* buying opportunities, and you'll profit from them if you do the routine *regularly*.

SolarWinds (SWI)



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You could have also used the Simple Weekend Routine to spot cloud computing leader SolarWinds *before* it broke out.

On October 17, 2011, the *IBD 50* noted that SolarWinds was “forming double bottom with potential 25.72 buy point.”

The stock broke out 10 days later—giving you plenty of time to have it on your watch

list and set up your buying game plan. **SolarWinds soared over 130% in just the next 11 months.**

Rackspace Hosting (RAX)



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Rackspace Hosting is another cloud computing company you could have found with the Simple Weekend Routine.

On January 20, 2012, *Your Weekly Review* highlighted Rackspace Hosting, saying its “first-stage cup-with-handle shows 45.56 buy point.”

Two weeks later, **Rackspace broke out and quickly rose 30% in only 9 weeks.**

Start *Your* Search for the Next Big Winners

Now that you know how powerful this simple routine can be, the next step is to start using it!

If you haven't already, take the Action Steps I've included at the end of the Simple Weekend Routine. Once you've done that, it's time to take a little challenge and find out what a *big* difference you can see in your investing skills in just a couple of weeks.

Take a Simple 2-Week Challenge

You've now seen the kind of money-making opportunities you'll find in every strong market uptrend. And you have a basic routine that shows you, step by step, how to identify them.

So what's next?

Let's turn that new routine into an old—and healthy—habit! And you can do that by taking the IBD 2-Week Challenge.

It's simple: **Try the Simple Weekend Routine and 10-Minute Daily Routine for the next 2 weeks.**

I think you'll be pleasantly surprised at how quickly your confidence grows and the quality of your watch list improves. You'll also find that once you do these routines a few times, you really can go through them in just a matter of minutes. And by combining these routines with the buying and selling checklists, you'll have a clear road map for making money in stocks.

You can do it. You just have to take the first step and start using these routines *regularly*.

To get going with the 2-Week Challenge and start building your watch list, visit www.investors.com/GettingStartedBook.

And while you're there, why not also sign up for free online training and check out the IBD Meetup group near you? Those are two great ways to kick-start your investing skills and start putting these routines and checklists into action—the right and profitable way.

5

• CHAPTER •

Selling Checklist

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Selling Checklist

Time to Sell or Hold?

Use this checklist to lock in your profits and cut short any losses.

While you can learn more advanced selling techniques later, start with these basic rules. They'll give you a sound game plan for achieving both profits and protection.

Offensive Selling: To lock in your profits

- ☐ Sell *most* stocks if they rise 20%–25% above a proper buy point.
Exception: If a stock rises *over 20% within just 3 weeks* from a proper buy point, hold the stock for at least 8 weeks.

Defensive Selling: To cut short any losses and protect remaining gains

General Market

- ☐ Take defensive action when *Market Pulse* outlook is “Uptrend under pressure” or “Market in correction.”

Your Stock

- ☐ Always sell if a stock drops 7%–8% below what *you* paid for it. No questions asked!
- ☐ **Chart Analysis:** Consider selling some or all of your shares if you see these signals:
 - Biggest single-day price decline since start of stock's run on heaviest volume in months
 - Sharp drop below 50-day moving average line on heaviest volume in months
 - Sharp drop—and close—below 10-week moving average line on heavy volume

You can download and print this checklist at www.investors.com/GettingStartedBook.

Want to Invest Well? Learn How to Sell Well!

Knowing when to sell is one of the trickier—and most overlooked—aspects of investing.

All too many folks jump into the market thinking only about what to *buy*, without giving much thought to when to *sell*. But as IBD Executive Editor Chris Gessel has said: **“Investing without sell rules is like learning to fly without learning how to land!”**

Don’t think of selling as something negative. It’s an essential part of investing that puts *you* in control of your money. Like the brakes on your car, sell rules don’t just keep you out of an “accident.” They let you stop and get out at your desired destination so you can cash in your profits at the right time.

As we go through the Selling Checklist, you’ll see our approach comes back again to the “big rocks”—the essential pillars of successful investing—we’ve been discussing throughout this book:

- Only buy stocks in a market uptrend. *Take defensive action as a down-trend begins.*
- Buy stocks being heavily bought by institutional investors. *Avoid those they’re heavily selling.*

The sell rules we’ll cover are easy to follow—if you keep those all-too-human emotions of fear, hope and greed on a tight leash.

I’ll be the first to admit, that’s not always easy to do. So before we go over the specific rules in the Selling Checklist, let’s take a look at 8 selling “secrets” that will keep you in the right frame of mind and help you take decisive action when it’s time to lock in your profits or cut short any losses.

Check the Chart for Clues on When to Sell or Hold

Would you like an “early warning detection system” for your stocks? Learn to read charts!

Once you understand a few common warning signs, you’ll know whether it’s time to sit tight—or get out. We’ll cover chart-related items on the checklist in Chapter 6, “Don’t Invest *Blindly*: Use Charts to See the Best Time to Buy and Sell.”

8 “Secrets” of Successful Selling

1. **Everyone makes mistakes! Just be sure to cut all losses short.**

Even the best investors get hit with a loss from time to time. But they don't dwell on it or wring their hands as the stock drops even lower. They cut their losses *quickly* and move on.

So leave your ego and pride at the door, and don't let a loss get to you—either mentally or financially. Stay out of trouble by sticking to the rules in the Selling Checklist.

2. **If you don't sell *early*, you'll sell *late*.**

Don't get greedy. Get disciplined! To lock in solid gains, sell while your stock is still going *up*. As Bill O'Neil has said, “Your objective is to make and take significant gains and not get excited, optimistic, greedy or emotionally carried away as your stock's advance gets stronger.”

I'll show you how to do that with our 20%–25% profit-taking rule.

3. **Have a selling plan in place *before* you buy.**

If you're a warm-blooded human being like the rest of us, you'll find the real drama kicks in when it comes time to *sell*. And if you don't have sell rules and an exit plan to guide you, it's easy to freeze and not take action when you need to.

If your stock is soaring higher, you may get a little greedy and want to grab every last nickel—not recognizing certain sell signals that tell you it could be heading for a fall. And if you're sitting on a loss, you may do the old “hold and hope” routine, praying it'll bounce back to break even—while it continues to put you even deeper in the red.

So make it easy on yourself: Have a clear selling plan in place *ahead of time*. Write down your target sell prices for both locking in your profits and nipping any losses in the bud. How do you do that? Just follow the Selling Checklist. It gives you a sound game plan for staying protected and profitable.

4. **Don't let a decent gain turn into a loss.**

It's no secret that stock prices fluctuate from day to day. Even if a stock is trending generally higher, it will have down days and weeks along the way. To make money, you need to sit through those swings and give the stock time to climb higher.

But if you have a nice gain of, say, 15%, 20% or better, and the stock begins to trend down, don't let that profit disappear completely.

Look for warning signs like those in the “Defensive Selling” section of the checklist. If institutional investors are clearly starting to sell, you'll want to lock in at least some of your profits. And if the general market uptrend is also starting to run out of steam, that's all the more reason to cash in the gains you have left.

If you choose to hold, have a target sell price in mind. For example, if your former 20% gain falls to, say, 10%, sell. The profit-taking price is up to you. The point is, you never want to “round-trip” a stock by riding it up to a big gain and all the way back down into a loss.

Believe me, it's *much* less frustrating to see a 15%–20% gain turn into a 5%–10% *profit* than it is to see it turn into a 5% *loss*. Don't forget: You can always buy back the stock if it rebounds and institutional investors start aggressively buying it again.

Use Trade Triggers to Protect Your Profits



You can set trailing stop-loss orders and other trade triggers with your broker to make sure a good gain doesn't slip into a loss (Chapter 4).

5. Don't marry your stocks. Just date them!

“For better or for worse, for richer or for poorer” is a noble and time-honored approach to marital fealty, but it's a bad idea when it comes to investing. In most cases, it's better to take a good gain while you have it, then move on to your next conquest. And never hesitate to cut yourself loose from a bad relationship if there are clear signs of trouble. (Remember: Don't try this at home with your significant other . . .)

6. Sell your *losing* stocks first.

If you were trying to build a champion baseball team, would you trade away your top players and keep all your benchwarmers? Of course not!

Yet many investors do just that: They sell stocks in which they have a good gain—and hold on to those showing a loss, thinking a big gain is just around the corner. That's usually wishful thinking. To build a powerhouse portfolio, you want to do the exact opposite: Sell your losers and use that money to add new winners to your roster or invest more in the top performers you already own.

7. When *buying* a stock, focus on both fundamentals and the chart action. When *selling*, focus on the chart action.

They say the view at the top is great, and that often applies to stocks as well. Market leaders will often still be posting stellar earnings and sales growth even as the stock begins to decline. That's because warning signs typically show up in the chart *before* they appear in the fundamentals (i.e., earnings, sales and other *company*-related criteria). It could be that institutional investors see trouble ahead and are starting to take their profits, or the overall market may be weakening. *Whatever the reason, when the chart flashes clear warning signs, you must take defensive action.*

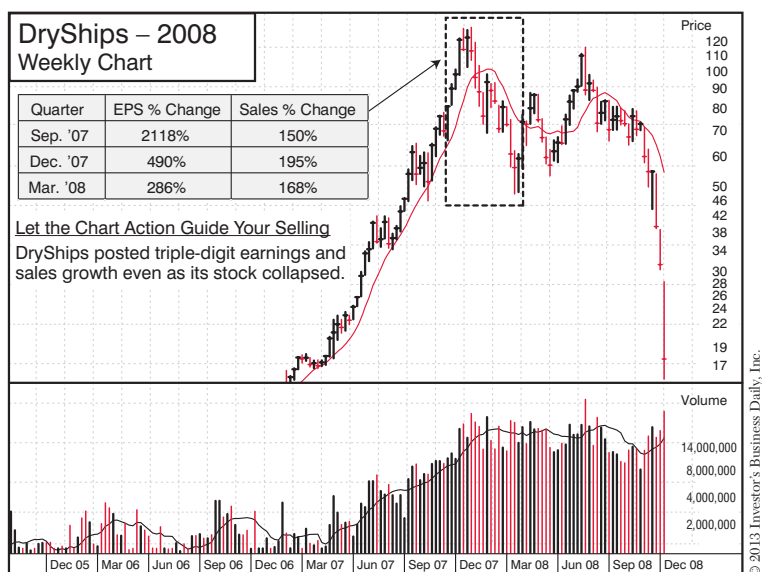
“All stocks are bad—except the ones that go up.”

—WILLIAM J. O'NEIL

That may sound funny, but Bill's message is serious. A stock could have phenomenal earnings growth and other outstanding CAN SLIM® traits, but if the share price is clearly tanking, why buy or hold it? It may be a great *company*, but at least right now, it's not a great *stock*. That's a very important distinction.

If fund managers are clearly dumping shares—which you can see by tracking the price and volume action in a chart—don't hold the stock just because it has great earnings. You're fighting a losing battle if you try to hold while institutional investors liquidate their positions.

DryShips was a classic example of this. Even though it was still posting explosive, triple-digit earnings and sales growth, big investors were *dumping* shares, pushing the stock into a clear downtrend. So what happened to investors who “married” the stock because they fell in love with the earnings? They quickly went from “richer” to “poorer,” as DryShips dropped from around \$130 to \$2 over the next 5 years. Something tells me those people now understand why it's so important to cut *all* losses at no more than 7%–8%.



The fall of DryShips: Focus primarily on chart action, not earnings, when it comes to selling.

Bottom line: When you see clear sell signals in the chart, just *sell*—even if the earnings look great. You may not know *why* institutional investors are dumping shares, but who cares?! You can find that out later, *after* you've protected your money by moving safely to the sidelines.

8. The most important sell rule is to *buy* at the right time.

Several years ago I had an epiphany that sounds incredibly obvious in hindsight, but it made a big difference for me: I realized that most of my mistakes came down to one simple problem—I was buying at the *wrong* time. I had a tendency to jump in a little early or chase stocks if I missed the breakout. So instead of starting with a nice gain, I often started with one foot already below the thin ice I was trying to walk on.

Fixing that one problem has made a huge difference, enabling me to launch new stock positions on more stable and solid ground.

Psychologically, it's *much* easier to make sell or hold decisions when you're sitting on a gain. When you have a loss, self-doubt—plus a mix of *hope* for a quick rebound and *fear* of an even bigger loss—can creep in and prevent you from making a level-headed, objective decision.

While not every trade will work out the way you want, if you always run a stock through the Buying Checklist before you buy, you'll be investing in quality stocks being bought heavily by institutional investors as they break out of a proper buy point during a market uptrend. That *greatly* increases the likelihood that you'll start off in the right frame of mind—and with a profit in your stock.

“Nothing ever becomes real ’til it is experienced.”

—JOHN KEATS

Unfortunately, I think there's a lot of truth to what Keats said. I say “unfortunately” because I'm afraid many people will just quickly read through these 8 “secrets” and move on before they really sink in.

Then down the road, they'll suffer a loss and realize, “By gosh, Matt was right! I *should* have cut my losses sooner!” or “Why did I let that big gain disappear?!”

In case you're wondering . . . Yes, I'm speaking from experience. I did indeed learn many of these “secrets” the hard way.

But that doesn't mean *you* have to! Reread this chapter from time to time to reinforce these key points and make sure you really take them to heart. They'll spare you a lot of unnecessary grief and help you experience a great deal of investing joy.

A Simple Selling Game Plan

The Selling Checklist covers the basics. There are more advanced sell signals to look for, and you can learn more about them in Bill O’Neil’s classic work, *How to Make Money in Stocks*, or by attending an IBD workshop and your local IBD Meetup group.

My goal here is to make sure you start out with a clear, easy-to-use plan—one you can begin using immediately to both grow your money and avoid any serious mishaps. Here it is.

• YOUR SIMPLE SELLING GAME PLAN •

- Sell *most* stocks when they go up 20%–25% from a proper buy point.
- *Always* sell if a stock drops 7%–8% below what you paid for it.
- Take defensive action as a market downtrend begins.

These 3 simple rules—both offensive and defensive—will serve you well. We’ll also get into other warning signs and sell signals, but when in doubt, stick to these 3 core principles.

3-to-1 Profit-and-Loss Ratio

The first step to making money in the market is to protect the money you already have, and sticking with this selling formula will help you do that.

Notice how the first 2 sell rules above give you roughly a 3-to-1 ratio: 20%–25% profits vs. losses of no more than 7%–8%. If you stick to this basic selling plan, you can be *wrong* on 2 out of 3 stocks and still come out slightly ahead or with just a minor loss. The next table shows how that works.

Use a 3-to-1 Profit-and-Loss Ratio to Grow—and Protect—Your Portfolio

Trade	Amount Invested	% Gain/Loss	\$ Profit/Loss	Total Value
#1	\$5,000	−7%	−\$350	\$4,650
#2	\$4,650	−7%	−\$326	\$4,324
#3	\$4,324	+25%	+\$1,081	\$5,405 (8% overall gain)

As I noted earlier, everyone makes mistakes and takes a loss sometimes. But if you cut *all* your losses short, you won't make any *big* mistakes.

And look what happens when your batting average improves. The table below shows how if you were right just 60% of the time (3 winners and 2 losers), you could walk away with a solid 69% profit.

Compound Your Gains and Minimize Any Losses

Trade	Amount Invested	% Gain/Loss	\$ Profit/Loss	Total Value
#1	\$5,000	−7%	−\$350	\$4,650
#2	\$4,650	+25%	+\$1,163	\$5,813
#3	\$5,813	+25%	+\$1,453	\$7,266
#4	\$7,266	−7%	−509	\$6,757
#5	\$6,757	+25%	\$1,689	\$8,446 (69% overall gain)

So be sure to use the Buying Checklist to get into quality stocks at the right time, then follow this basic selling game plan to lock in your gains and limit any losses.

By doing that, you can start delving into the market with confidence, knowing you're safeguarding your money from undue risk while also laying a solid foundation for compounding your profits over time.

Offensive Selling to Lock in Your Profits

A quick note on charts before we jump in.

As we go through the Selling Checklist, I'll touch on chart-related terms like "base pattern," "cup-with-handle," "ideal buy point" and "proper buying range." If you're not familiar with those concepts, don't worry. We're going through this one step at a time—and we'll cover all that in due course.

For now, just stay focused on the basic selling game plan: Take most profits at 20%–25%; cut all losses at no more than 7%–8%; and take defensive action as a market downtrend begins.

We'll get into chart-based sell signals in Chapter 6, "Don't Invest *Blindly*: Use Charts to *See* the Right Time to Buy and Sell."

Selling Checklist

Offensive Selling: To lock in your profits

- ☐ **Sell *most* stocks if they rise 20%–25% above a proper buy point.**
Exception: If a stock rises over 20% *within just 3 weeks* from a proper buy point, hold the stock for at least 8 weeks.

☒ *Sell most stocks if they rise 20%–25% above a proper buy point*

Especially when you're new to investing, this rule will help you hit the kind of singles and doubles that will grow your money—and your confidence. It's tempting to think you should swing for the fences and only try to hit home runs and grand slams, but that's not likely to happen. And fortunately, it doesn't have to. You can generate very impressive profits by stringing together a few 20%–25% gains. Here's why.

The Rule of 72

I first came across this rule when I read *Beating the Street* by legendary mutual fund manager Peter Lynch in the mid-1990s. It's a handy calculation to see how quickly you can basically double your money.

Here’s how it works: Take the gain you have in a stock (or any other investment), described as a percentage. Then divide 72 by that number. The answer tells you how many times you have to compound that gain to essentially double your money.

For example, let’s say you nailed down a 24% gain in a stock. 72 divided by 24 is 3. That means if you reinvested that same money (including your 24% profit) and got two more 24% gains, you’d nearly double your money.

You’ll find it’s easier to get three 20%–25% gains in a few different stocks than it is to score a 100% profit in one. As the following table shows, if you compound those gains, those smaller wins turn into major profits.

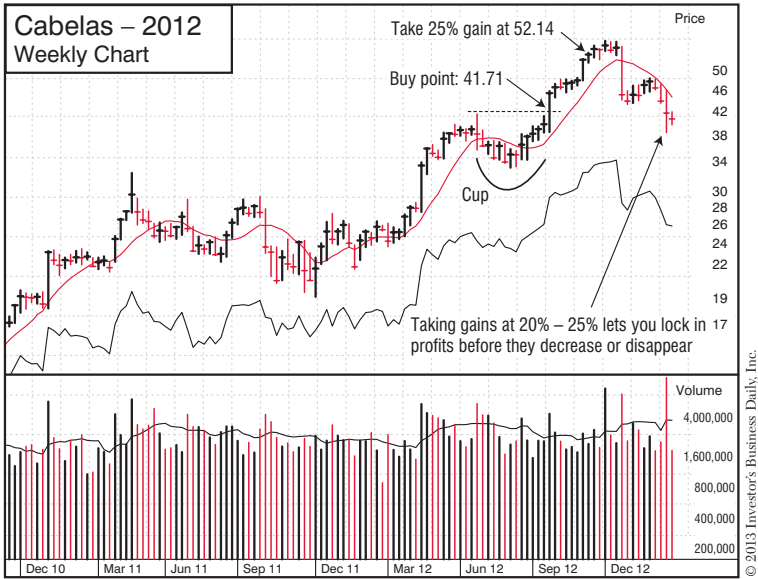
How Smaller Gains Can Lead to Big Profits				
Trade	Amount Invested	% Gain	\$ Profit	Total Value
#1	\$5,000	24%	\$1,200	\$6,200
#2	\$6,200	24%	\$1,488	\$7,688
#3	\$7,688	24%	\$1,845	\$9,533
				(91% overall gain)

Why Sell at 20%–25%?

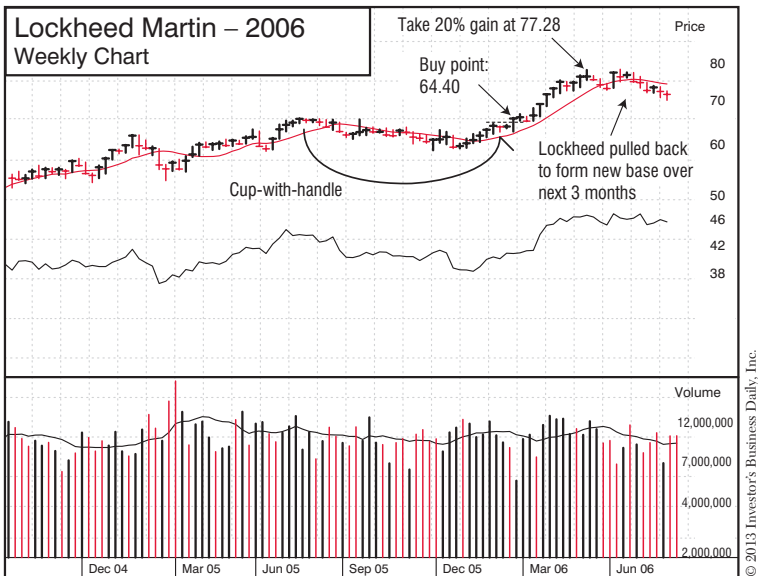
In a word, history. We’ve studied all the top stocks since 1880, and here’s what typically happens: When a stock breaks out of a proper buy point and rises 20%–25%, it usually pulls back and forms a new chart pattern, like a cup-with-handle, double bottom or flat base.

So rather than sit through that correction (i.e., decline) and watch some or all of your profits disappear, it can be a good opportunity to lock in those gains. That ties into one of the 8 “secrets” of successful selling we saw earlier: “If you don’t sell early, you’ll sell late.” In other words, take your gains on the way *up*, before the stock comes back down and takes a big chunk of your profits with it.

See the following charts for two examples of how the 20%–25% profit-taking rule helps you nail down some nice gains.



Taking most gains at 20%–25% helps build your portfolio and your confidence.



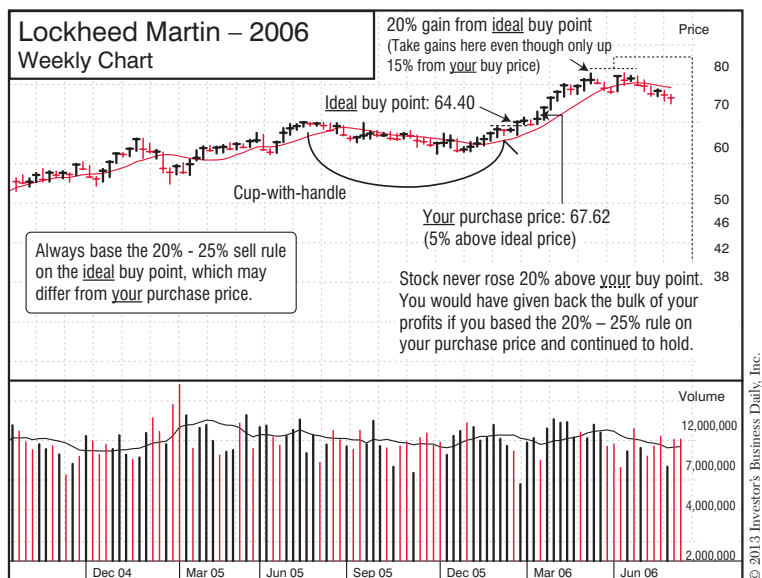
Don't let a good gain slip away. Following the 20%–25% sell rule helps you lock in and compound your profits.

Important Note About the 20%–25% Rule

The 20%–25% gain is calculated from the stock's ideal buy point. That may be different from your own purchase price.

As you'll see later when we discuss chart patterns, the buying range for a stock is from the ideal buy point up to 5% above that. So let's say you bought 4% above the *ideal* buy point. If the stock then rose 20% above the ideal buy point, *your* profit would be 16%.

Below is an example of how to properly apply the 20%–25% sell rule.



Always buy as close as possible to the ideal buy point. One way to do that is to set automatic trade triggers to buy stocks right when they break out (see Chapter 4).

I'm emphasizing this because I misunderstood this rule when I was starting out—and it cost me money. I thought I should sell a stock when *my* gain was 20%–25%. On more than one occasion, I'd be up 15% or so, just waiting for the stock to hit that 20% benchmark. But it would pull back before reaching that target, and I'd end up taking a much smaller gain or in some cases a loss. (Apparently, I had to take some lumps before I took to heart the idea that you should "never let a decent gain turn into a loss.")

It wasn't until I reviewed some past trades that I realized my mistake. I was buying 4%–5% above the ideal buy point, but I was basing the 20%–25% rule on *my purchase price* instead of on the stock's ideal buy point. (That's just one example of why reviewing your trades is so important. See Chapter 7 for how to do a profitable post-analysis and fix any bad habits.)

Don't Ignore a Winning Stock After You Sell It!

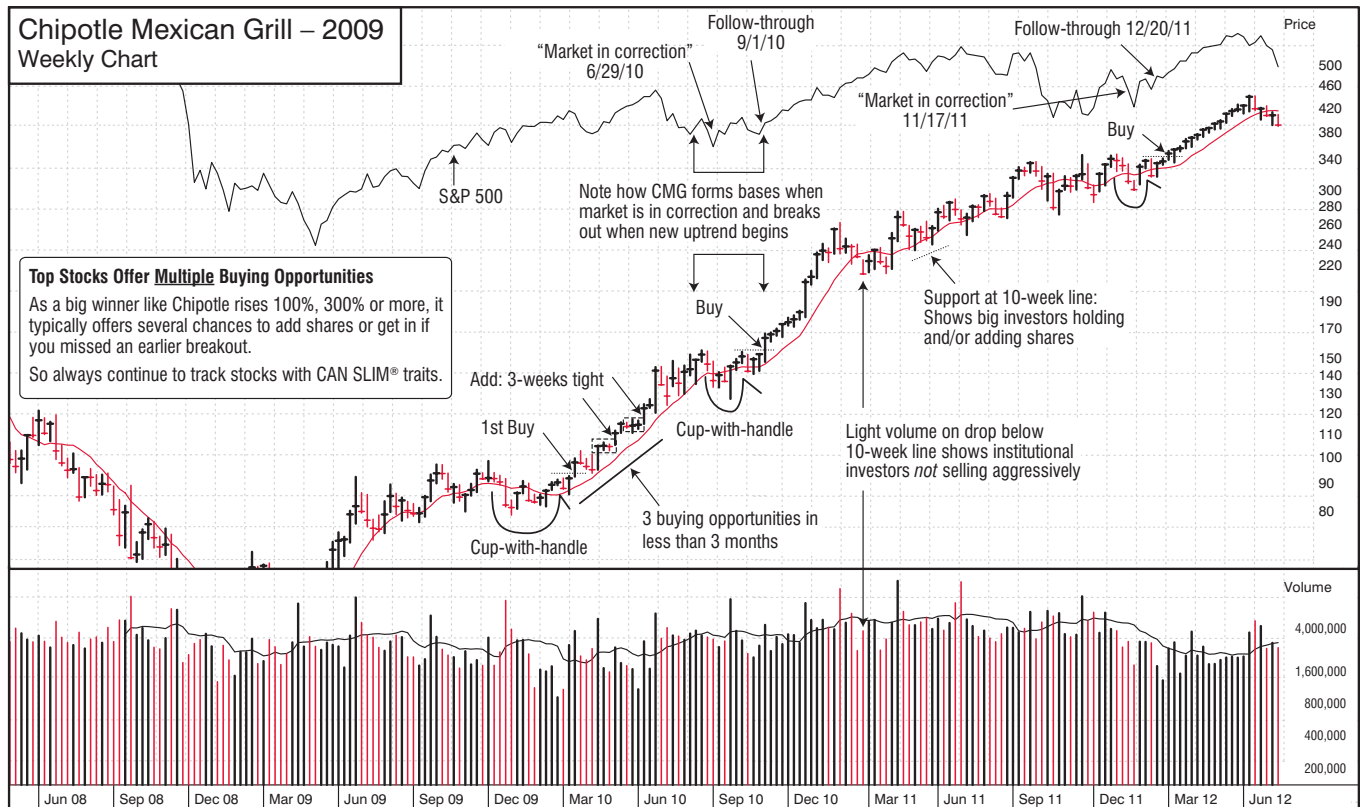
The Best Stocks Give You *Multiple* Money-Making Opportunities

The best stocks will typically form multiple base patterns as they double or triple in price. Like a hiker, they'll go up for awhile, rest (or maybe slide down the hill a bit), then continue the climb.

So when you sell a stock that hits that 20%–25% benchmark, it's not necessarily the end of the story. Watch to see what happens next. Does it pull back and form a new cup-with-handle or other base pattern? Or does it climb higher, then move sideways to form a 3-weeks tight or flat base? These and other scenarios can give you another opportunity to buy the stock and profit again.

It's absolutely critical that you continue to track these winning stocks. They have the CAN SLIM® traits, and they've proven they have the power to break out of a good chart pattern and make a nice gain. If they do repeat that winning process, why not grab another piece of those *additional* profits?

The chart for Chipotle Mexican Grill shows an example of how that can work.



Continue to track leading stocks: *IBD 50*, *Your Weekly Review* and other features alert you to multiple buy points as the top stocks make their big moves.

Also keep this in mind: Since you've already owned the stock once, you know its story, and if you're using charts, you know its trading "personality." That makes it easier to handle the stock properly and spot any changes in trend.

It also makes it easier to capture a sizable chunk of a big winner's gains—without the stress of having to sit through major sell-offs that may happen along the way.

When a stock like Apple, Priceline.com or Green Mountain Coffee Roasters goes up 1,000% or more, you probably won't capture that whole gain. But by following the 20%–25% rule—and continuing to track a winner even after you sell—you can certainly grab multiple 20%+ profits in that stock. And the "Rule of 72" shows how a few of those gains can very quickly increase the size of your portfolio.

Don't Forget the General Market!

Stocks don't operate in a vacuum. Like the moon's effect on the tides, the direction of the general market has an enormous pull on individual stocks.

You'll often find that stocks hit that 20%–25% target, then pull back to form new bases at the same time the *overall* market uptrend is starting to run out of steam.

See the connection?

Winning stocks make their climbs when the overall market is trending higher, and they'll start to pull back when the market weakens. That's why it's important to be on the lookout for any changes in market direction by regularly checking the *Market Pulse* in *The Big Picture* column.

We'll get into the role of the general market more when we talk about "defensive selling," but for now, just make a mental note of how closely the 20%–25% sell rule is tied to the ebb and flow of the *overall* market.

Important Exception to the 20%–25% Sell Rule

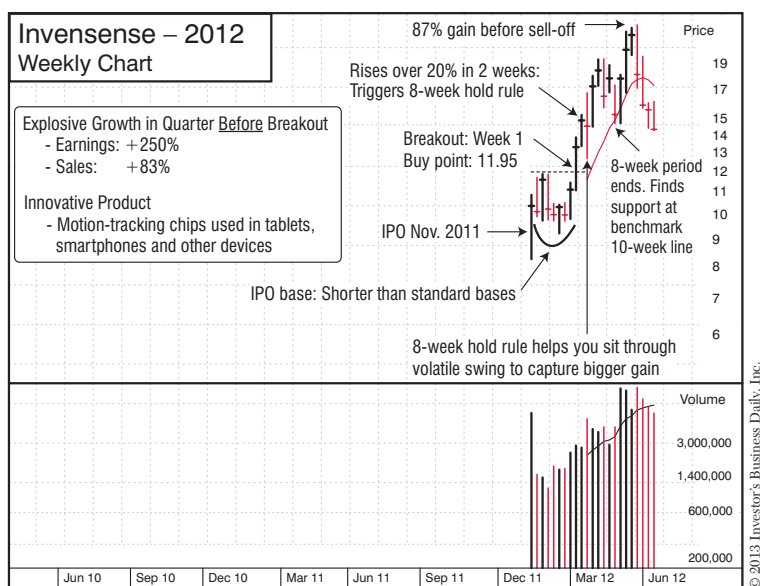
If a stock rises over 20% within just 3 weeks from a proper buy point, hold the stock for at least 8 weeks.

Stocks that show that kind of power have the potential to go on to even bigger gains. It's an indication that institutional investors are aggressively establishing new positions or increasing existing ones, and that's what fuels a big, sustained climb.

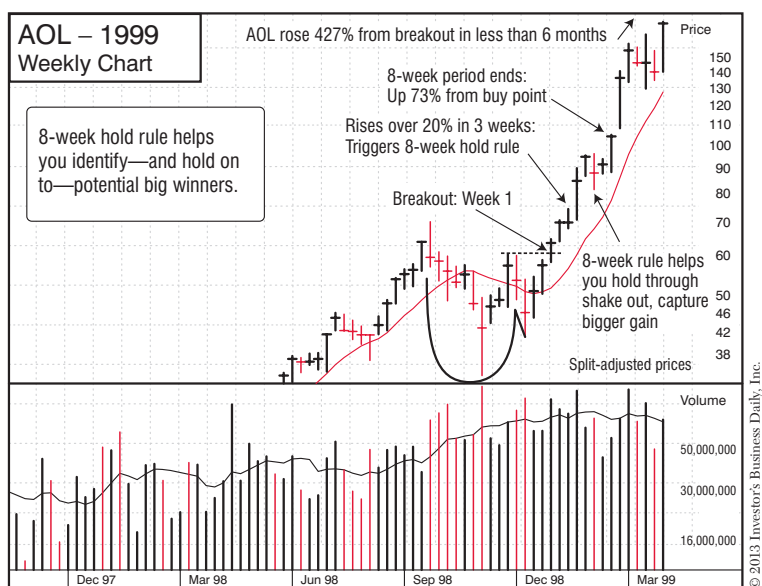
But it's unlikely the stock will go straight up without some bumps along the way. In fact, soon after a stock makes that initial jump, it may pull back sharply as some investors take their short-term profits. If the stock is exceptionally strong, it will shake off that temporary setback and continue its upward move.

The purpose of the 8-week rule is to help you sit through any sudden pull-backs so you can hold on for potentially much larger profits. Without such a rule, it's easy to get scared out of the stock and sell too early.

See the following charts for 2 examples of how the 8-week rule can help investors hold on for big gains.



The 8-week hold rule helped investors sit tight and grab a bigger chunk of Invesense's 87% gain.



Without the 8-week hold rule, it's easy to get nervous and sell a big winner too soon.

3 Notes on the 8-Week Hold Rule

1. Don't apply this rule to just any old stock. Make sure it is a true market leader with superior earnings and sales growth, solid institutional sponsorship and other CAN SLIM traits.
2. Note that the week of the breakout counts as week #1 in the 8-week count. See the examples in the previous two charts.
3. This rule only applies to stocks that have just broken out of a proper base. Do *not* apply this rule to a stock that suddenly shoots up 20% or more *without* first breaking out of a cup-with-handle or other chart pattern. For example, a stock may shoot up 20% or more on a good earnings report, but that only triggers this rule if the move comes as it breaks out of a base (see Chapter 6 for more on bases and chart-reading).

What to Do When the 8 Weeks Are Up

After the 8-week holding period ends, you have a choice to make: Sell or hold the stock?

Here are a few questions to help you decide:

- Has the stock climbed substantially higher during those 8 weeks, or have you given back most of your gains? Is your former good gain on the verge of turning into a loss?
- If the stock has pulled back, did it find support at key areas, such as the 10-week moving average line or a former area of resistance? That would show big investors are holding onto their shares. Or has it been falling *below* those key benchmarks on heavy volume? That shows fund managers could be liquidating their positions—and it may be time for you to do the same.
- Is the overall market still in a confirmed uptrend, or has the outlook changed to “uptrend under pressure” or “market in correction”?

When you combine your answers to those questions with your own risk tolerance, the decision to sell or hold should become fairly easy. Keep in mind: You don't have to sell *all* your shares. You could choose to sell just a portion. That lets you lock in some of your profits but still keep a position in case the stock shoots higher. And if the stock is forming a new base or running into trouble, you can always sell now and buy it back if the stock rebounds and again passes the Buying Checklist.

Profits Come to Those Who Grab Them

Not every stock you buy will be the next Priceline.com, Netflix or Lululemon Athletica—with a 100%, 500% or 1,000%+ gain.

And even when you do latch on to big winners (and you *will* if you stick to these checklists and routines), those stocks don't go straight up. They take breathers along the way—and if the market is particularly weak, they may drop *sharply* before they (hopefully) resume their climb.

That's why you need *offensive* sell rules to cash in your profits while you still have them.

You can do that if you just follow the key points we've discussed here:

- Take most profits at 20%–25%.
- Be ready to lock in at least some of your gains when the market weakens.
- Use a 3-to-1 Profit-to-Loss Ratio to systematically grow and protect your money.

As you improve your stock-picking and chart-reading skills, you'll become even more adept at capturing multiple 20%–25% gains from the same stock—and at holding “monster” stocks for even bigger profits.

But the key right now is to start right. And if you stick to this simple selling game plan, you'll grow your portfolio—and your confidence—by hitting safely for a lot of singles and doubles.

• ACTION STEPS •

Here are some quick *To Dos* to help you start capturing profits using the Selling Checklist. To take these steps and start improving your selling skills, visit www.investors.com/GettingStartedBook.

- Watch 2 short videos on offensive selling:
 - *Take Most Profits at 20%—25%*
 - *Use the 8-Week Hold Rule to Help Capture Bigger Gains*

Defensive Selling to Cut Short Any Losses and Protect Your Gains

I think this is true for just about any investor: We start out with 2 basic emotions—hope and fear. We *hope* we'll make a ton of money ASAP. But we also *fear* we'll lose our shirts.

Wouldn't it be nice to have a little peace of mind—some simple guidelines that will make sure you don't get burned?

That's where the “Defensive Selling” segment of the checklist comes in.

To avoid any serious damage, just follow these basic sell rules. If you do that, even when a severe bear market hits like it did in 2008, you can rest easy, knowing you've proactively protected yourself by sticking to a sound game plan.

Let's start with a look at the first two “Defensive Selling” criteria. Then we'll get into the chart-related items in Chapter 6, “Don't Invest *Blindly*: Use Charts to *See* the Best Time to Buy and Sell.”

Selling Checklist

Defensive Selling: To cut short any losses and protect remaining gains

General Market

- ☐ Take defensive action when *Market Pulse* outlook is “Uptrend under pressure” or “Market in correction.”
-

Your Stock

- ☐ Always sell if a stock drops 7%–8% below what *you* paid for it. No questions asked!
-

Notice how I've divided this part of the checklist into “General Market” and “Your Stock.”

As we keep emphasizing, individual stocks don't operate in a vacuum—most get pulled in whatever direction the general market is currently heading.

While it's ultimately the behavior of your stock that determines whether you should sell or hold, you should *always* take into account what's happening in the overall market.

You may drive a finely tuned luxury sports car, but if the road is covered in oil slicks and ice, you might want to slow down! It's the same with investing: How you "drive" your portfolio depends on current market conditions. So let's start there.

Selling Checklist

Defensive Selling: To cut short any losses and protect remaining gains

General Market

- ✓ Take defensive action when the Market Pulse outlook is “Uptrend under pressure” or “Market in correction”

By now, I think this point is clear: **You *must* protect yourself when the market comes under pressure and begins to fall into a correction.**

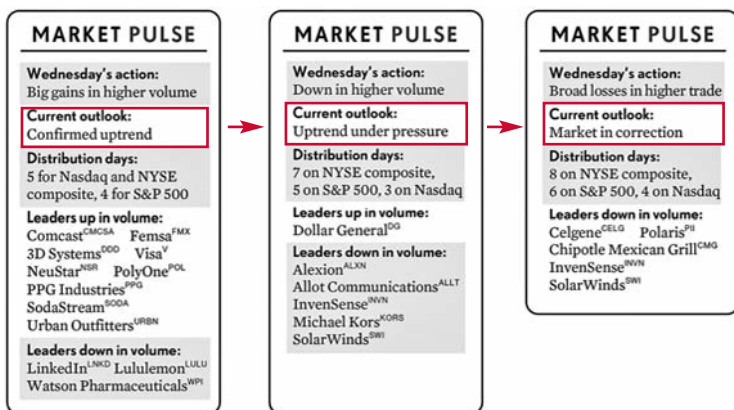
Remember: **You *do not* have to be invested in the market at all times.** Your goal is to make money when the market is trending higher and protect those profits when it heads south.

How Do You Know When the Market is Running into Trouble?

Check the *Market Pulse* in *The Big Picture* column.

We covered this earlier in the section on Big Rock #1 in Chapter 3, so we’ll just do a quick recap here and focus on what steps you can take to protect yourself in a weak market.

IBD’s 3-stage approach lets you know if selling pressure is rising, which could mean the current uptrend is on the verge of falling into a correction. Think of it like a traffic light that goes from green (“Confirmed uptrend”) to yellow (“Uptrend under pressure”) to red (“Market in correction”).



Distribution Days Alert You to Mounting Trouble

When the market is in an uptrend, we watch for “distribution days”—days of heavy selling in at least one of the major indexes, primarily the Nasdaq, S&P 500 or Dow Jones Industrial Average (see Big Rock #1, Chapter 3).

If the number of distribution days starts to rise, watch out! That shows institutional investors are moving to the sidelines, which may mean the current uptrend is running out of steam.

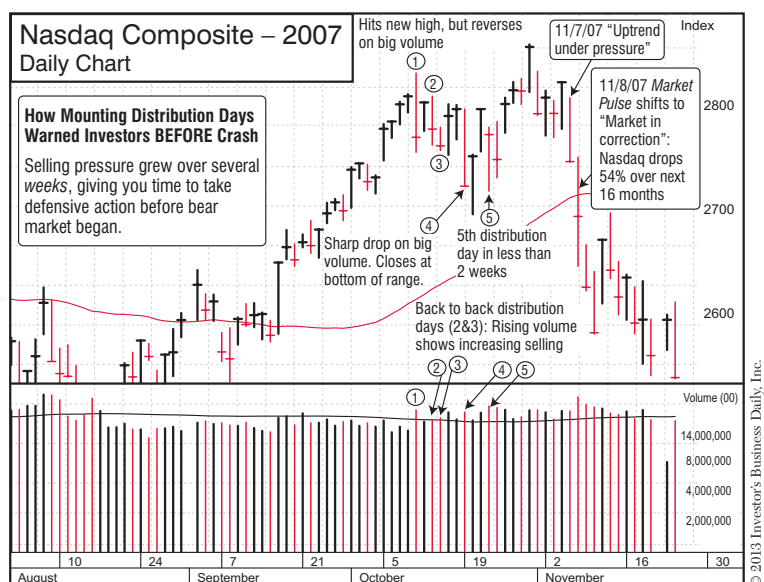
If you get 6 distribution days over any 4- to 5-week span, the general market almost always falls into a correction.

You can easily track the number of distribution days just by checking the *Market Pulse* (see examples above). If the count continues to grow, the outlook will shift from “Confirmed uptrend” to “Uptrend under pressure” and finally to “Market in correction.” (The number of distribution days needed to turn the market into a correction may change over time. Regularly read *The Big Picture* to stay aware of any adjustments.)

Think about how valuable that 3-stage progression is.

While some markets are more volatile, **changes in market trend typically happen over a few weeks, giving you time to protect your money.**

Earlier, we saw how distribution days mounted in March–April 2012 as the market rolled over into a correction (Big Rock #1, Chapter 3). We also noted how shifts in the *Market Pulse* helped investors avoid any serious damage when the financial and housing crisis pushed the market into a severe bear market starting in November 2007 (Big Rock #1, Chapter 3). Let’s take a closer look at how that latter episode played out—and how you can use distribution days to help safeguard your portfolio whenever future downtrends emerge.



Regularly checking the distribution day count in the *Market Pulse* in *The Big Picture* column will help you know when it's time to play defense and protect your gains.

What Action Should You Take as Distribution Days Mount?

First and foremost, make sure you're following your selling game plan.

- **Look for opportunities to lock in some profits.** If you have a stock that's gone up 20%–25% from a buy point, why not cash in some or all of those gains? If the number of distribution days continues to rise, there's a good chance your stocks will also get dragged down.
- **Cut any losses short.** Even in a *strong* market, if a stock drops 7%–8% below what *you* paid for it, sell immediately. In a *weakening* market, you can cut your losses even sooner—at, say, 3%–4%. Better to be safe than sorry.

Here's a basic guideline for how to handle a rising number of distribution days:

# of Distribution Days	Action
1	No special action needed
2	No special action needed
3	Start watching your stocks even more closely
4	Look for something to sell
5 or 6	Proactively take defensive action if your gains are threatened or you have small losses

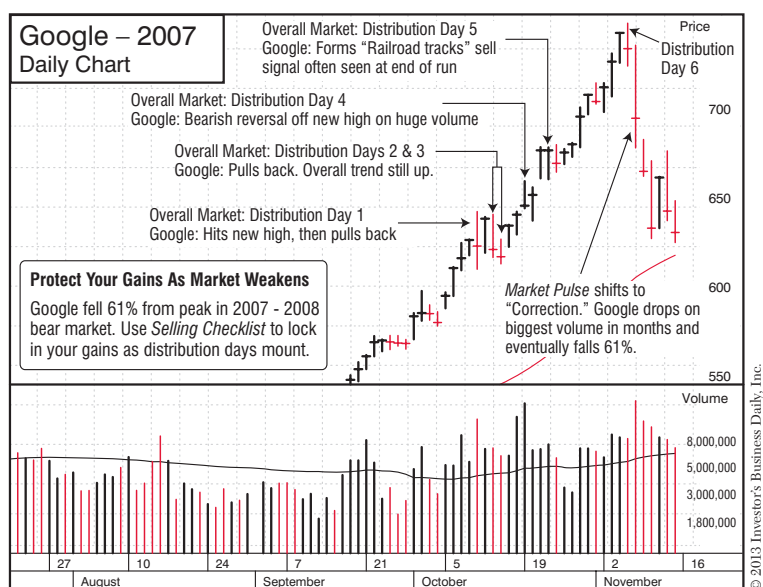
You can see from the table above that 1 or 2 distribution days is not a cause for concern. But when you get a third day, take note. Make sure you're keeping a close eye on each of your stocks and following your selling game plan. That way you'll be ready to act decisively if we get even more distribution days.

When the distribution day count reaches 4, look for something to sell. Selling pressure is on the rise, so it's an opportunity to shed your *weaker* holdings. Remember one of the 8 "secrets" of successful selling: Sell your *losing* stocks first! Don't make the mistake of selling your winners while holding your laggards.

Why should you look to sell something when you have 4 distribution days?

Because by the time the general market has 5 or 6 distribution days, many leading stocks may have already taken a hit. So be proactive and reduce your exposure by selling any stocks showing weakness. For example, a stock may be dropping lower on increasingly heavy volume—a sign institutional investors are selling.

See the next chart for an example of how you could have locked in your gains using the *Market Pulse* and basic sell rules.



Stay profitable and protected: Take defensive action as distribution days mount and the market weakens.

One Important Caveat

If an uptrend is already established (i.e., at least a few weeks old) and rolling along just fine, you don't need to worry about the first couple of distribution days. However, *if you see distribution right after a new uptrend begins, that is definitely cause for concern.* It could mean the nascent uptrend is not taking hold and will quickly fall back into a correction.

The Big Picture column alerts you to those types of warning signs, so be sure to read it regularly as part of your investing routine.

Beware the Double Whammy!

If your stock is flashing warnings signs *and* the overall market is coming under increasing selling pressure, that's two strikes against you. Big investors are getting out of the market in general and out of your stock in particular. The classic double whammy.

Why hold on and take the chance of striking out completely? Why leave yourself at the mercy of the market?

It's your money—take control and protect it by sticking to the Selling Checklist.

Take Your Profits—and Cut Your Losses—Even Sooner in a Weak Market

The basic selling game plan says you should:

- Take **most** profits at 20%–25%
- Cut **all** losses at no more than 7%–8%

But you can—and should—adjust that in a weak market. As a rule of thumb, keep the 3-to-1 Profit-to-Loss Ratio we discussed in “Offensive Selling.”

For example, you could take your profits at 10%–15% and cut any losses at no more than 3%–5%. It’s just like slowing down and driving more cautiously in heavy fog: The normal speed limit may be 65 mph, but do you drive that fast when you can’t see the road?

So always adjust your game plan based on current market conditions. That’s how you arrive safely at your destination.

3 Tips on How to Handle a Market Correction

By the time the outlook in the *Market Pulse* changes from “Confirmed uptrend” to “Uptrend under pressure” to “Market in correction,” you’ve probably already sold at least some of your positions. Either you hit your target profit goals and locked them in, or your stocks triggered sell rules found in the Selling Checklist.

But keep in mind: *You do not have to automatically sell all your stocks when the market is in a correction.* If you have a large gain in a particularly strong leader that is holding up relatively well, you may choose to sit tight.

(Note: Holding *some* stocks is fine, but if you’re still *fully* invested during a market correction, you probably need to take a closer look at your portfolio. Make sure you’re properly following the selling game plan and taking heed of the 8 “secrets” we discussed earlier.)

Here are 3 proven ways to stay safe in a market downturn—and get ready to make more money in the next uptrend.

1. Don’t make new buys.

You now know that most stocks move down when the market is in a correction, so why risk it? Wait for a new uptrend to begin before making any new purchases.

2. Protect yourself.

Remember your primary goal: Make money in an uptrend—and safeguard those gains when the market weakens.

What's the point of scoring nice gains in a strong rally, if you're only going to give them all back when the market direction changes? You can easily avoid "round-tripping" your stocks simply by following the Selling Checklist.

If you do hold stocks during a correction, understand that the market tide is against you. You need to remain vigilant and ready to protect yourself if your stocks start to seriously weaken. Here's how to do that:

- **Make sure you have a large enough gain** to "cushion" yourself against a potential drop. It's risky to hold in a downtrend if you're at breakeven or just sitting on a small gain.
- **Set a target sell price.** Decide how much of your profit you're willing to give back if the stock sells off. For example, if you have a 75% gain, you might be willing to ride that down to 50% but no further. If the stock hits that price, cash in your remaining profits.

You can set automatic trade triggers to make sure you stick to your target sell price (Chapter 4).

- **Consider selling at least a *portion* of your shares.** That's a way to nail down guaranteed profits, but still have a position in the stock if it continues to climb.

3. Prepare *now* to profit in the next uptrend.

We touched on this earlier, but I want to make sure it really sinks in: If you stop doing your investing routine while the market is *down*, you won't be ready to make big money when it moves back *up*!

In the stock market, good things don't come to investors who just wait. Good things—and stellar profits—come to those who *prepare*.

Now you may be wondering: Why should I keep doing my routine and look for winning stocks if I'm not even supposed to make new buys in a correction? Here's the answer . . .

Why You Must Stay Engaged During a Market Downtrend

- **The market direction can change very quickly.**

When we're in a correction, the market is never more than 4 days away from a potential new uptrend. That's all it takes for a "follow-through day" to kick off a new rally (Big Rock #1, Chapter 3).

And remember: New uptrends often begin when the news is terrible. So if you stay focused on the doom and gloom headlines and ignore the

Market Pulse outlook, you probably won't realize—until it's too late—that a new rally has begun.

- **Most stocks form new bases—the chart patterns that launch big new moves—during market corrections.**

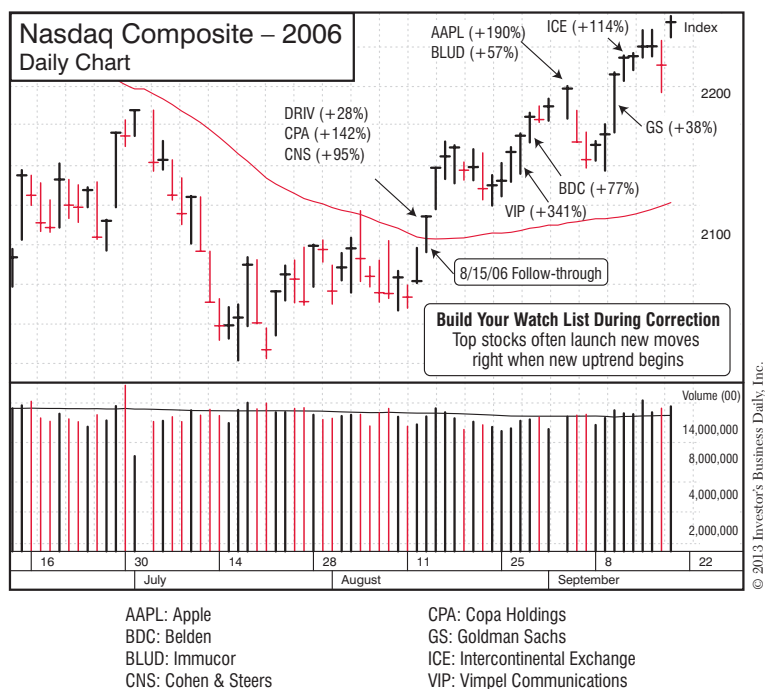
If you're *not* checking the *IBD 50* or other lists for top-rated stocks forming bases, you won't have them on your watch list when a new uptrend begins.

- **The big money is made in the *early* stages of a new uptrend.**

What typically happens after the *Market Pulse* outlook changes from “Market in correction” to “Confirmed uptrend”?

The strongest CAN SLIM® stocks shoot out of the gate. They break out of the cup-with-handle or other chart pattern they formed during the correction, and generate nice profits for those investors who were paying attention and staying alert.

The following chart shows just some of the money-making opportunities that always pop up in the early stages of a strong new uptrend.



Be prepared: The best stocks launch new moves right when a new uptrend begins.

This is a critical point to understand, so be sure to go back and look at the other examples we saw earlier for uptrends that started in 2003, 2010 and 2011 (see Big Rock #1, Chapter 3).

And remember: This is *not* a case of 20-20 hindsight. You'll find many of these leading stocks on the *IBD 50*, *Your Weekly Review*, *Sector Leaders*, *Stock Spotlight* and other lists before they break out if you regularly use the daily and weekend routines we went through in Chapter 4.

Protect. Prepare. Profit.

I don't know what your perception of the stock market was before you started reading this book, but I hope by now you realize these 2 things:

- **You do *not* have to be at the mercy of the market.** You *can* see the right time to get in—and out.
- **You should *not* get frustrated by a downtrend—even a severe one.** Protect yourself by following the Selling Checklist, then prepare to profit from the huge money-making opportunities that *will* appear in the next strong uptrend by sticking to the Buying Checklist and simple routines.

Next up: Now that you know how to handle a *weak* market, let's talk about how to handle weakness in your own *stocks*.

• ACTION STEPS •

Here are some quick *To Dos* to learn more about how to spot weakness in the general market—and what to do about it. To take these steps, visit www.investors.com/GettingStartedBook.

1. Read *The Big Picture* column.
 - Is the market currently in an uptrend—or correction?
 - What else does it say about current market conditions?
2. Watch short videos on:
 - *Sell or Hold? How to Review Your Stocks in a Weakening Market*
 - *How to Handle a Market Correction*
 - *What to Do After a Follow-Through Day*

Selling Checklist

Defensive Selling: To cut short any losses and protect remaining gains

Your Stock



*Always sell if a stock drops 7%–8% below what you paid for it.
No questions asked!*

Whether it's the dot-com crash in 2000 or the financial crisis in 2008, we hear horror stories of people who lose 30%, 50% or more of their money in a severe bear market. That's heart-wrenching—especially because it's so easy to avoid.

Just follow this one simple rule: **Cut all losses at no more than 7%–8%.**

It's extremely effective and easy. No charts to read, no fancy technical indicators to look for. If the stock drops 7%–8% below what you paid for it, just get out!

So why doesn't *everybody* follow this rule?

I think the first reason, frankly, is ignorance. Millions of people simply don't understand how market cycles work. And they don't have any sell rules to protect themselves.

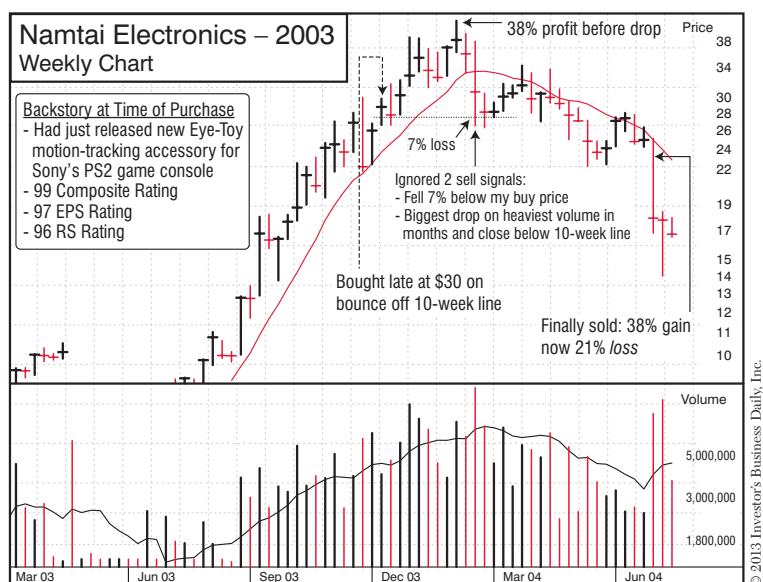
The second reason is emotions.

We're all human, and we don't like to admit when we're wrong. So instead of quickly cutting a loss, the natural inclination for many investors is to hold and hope it bounces back.

Big mistake! That's how a little loss becomes a big one.

And here's a paradox about selling: *If you have a hard time selling a loss when it's small, it'll be that much harder to sell as it gets bigger.* That's when denial and delusion start to really kick in.

Believe me, I've been there. The following chart shows how I stubbornly held on to a former leader called Namtai Electronics when I was just starting out.



I learned my lesson: Always sell if a stock drops 7%–8% below what you paid for it.

I made two mistakes:

1. I let a decent gain disappear and turn into a loss.
2. I let a small loss become a big one.

Here's a very important point: I *knew* the rules but chose not to *follow* them.

I think we all come face to face with that issue at some point, especially when starting out. It's one thing to *have* rules. It's quite another to actually stick to them in the heat of battle.

There can be a big difference between how you *think* you'll behave and what you actually *do* when you have money on the line. It's like playing poker for peanuts or potato chips: It's just not the same unless you have skin in the game.

I know the 7%–8% sell rule sounds obvious and sensible, so it's easy to just read this and move on. But it is absolutely essential that you take this rule to heart. It will be an *indispensable* part of your success.

There's a great scene in the movie *Good Will Hunting* where Robin Williams, a psychiatrist, confronts Matt Damon, a troubled but brilliant student who comes from a broken family. In an effort to get Damon to realize

he's not responsible for what his family did, Williams looks at him and says, "It's not your fault." Damon half-heartedly accepts that, but it's clearly not really sinking in. So Williams physically grabs Damon and keeps repeating, "It's not your fault, it's not your fault," until Damon truly gets the message.

So, this is my way of grabbing you by the lapel to say again and again: "You *must* cut all your losses short."

"When you find yourself in a hole, stop digging."

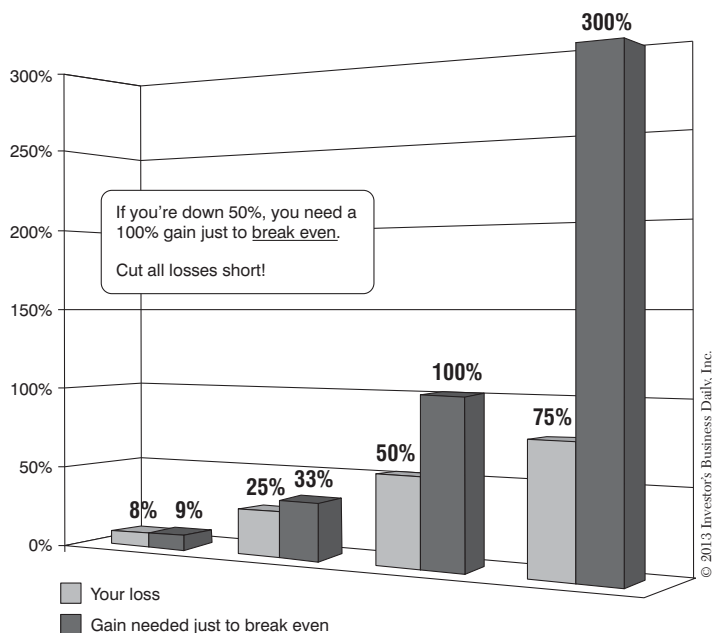
—WILL ROGERS

When you start investing you have 2 choices:

1. You can jump in *without* a "protection plan" and no limit on how much money you might lose.
2. Or you can set a specific limit and cap any potential losses.

Pretty straightforward decision, right? And all you have to do to limit your losses is just follow the 7%–8% sell rule.

The following graph shows why that's so important.



If you want to make big money, keep all your losses small.

If you cut a loss at 8%, you only need a 9% gain to get back to breakeven. But the deeper your loss becomes, the harder it is to make yourself whole again. If you take a 50% loss, you need to *double* your money just to break even. It's not that often you grab a 100% gain, and when you do, you want to *profit*—not just make up for a past *loss*!

(Buy and) Holder Beware!

This is a good time to recall 2 key facts we touched on earlier. If *they* don't reveal the dangers of “buy and hold” investing, I don't know what will.

- **Once leading stocks eventually peak, they decline 72% on average.**

Here's what happened to selected leaders in the 2007–2008 bear market. It's a vivid reminder that even leading CAN SLIM stocks eventually peak and must be sold.

Declines of Selected Leading Stocks in 2007–2008 Bear Market

Company Name	% Decline
Apple	–56%
Baidu	–67%
China Mobile	–63%
Dick's Sporting Goods	–71%
Google	–61%
Intuitive Surgical	–71%

That may look scary, but remember: You can easily avoid that damage. **Lock in the bulk of your profits and cut short any losses by following the Selling Checklist.**

- **Only about 1 in 8 stocks that led in the prior bull market go on to lead again in the next one.**

Those are not good odds.

Now you may be thinking, “What about stocks like Apple or Priceline.com or Monster Beverage? They made big gains in multiple bull markets.”

Yes, there are exceptions. But they're relatively rare. And as a former leader is dropping 72% or so, do you really want to take that loss and bet

the farm it'll be one of those rare exceptions? Even if it does bounce back, do you want to start that new run with the profits you locked in when the downtrend began—or *down 72%*?

Look again at the chart above that shows the gains you need to make up for past losses. If you hold on as a former leader drops 75%, you need a 300% gain just to break even! So if that stock falls to \$20, you won't make a dime in profit until it climbs back *above* \$80.

So let's review . . .

You can hold as your stock loses most of its value, with only a 1 in 8 chance it'll come back to be a big winner again.

Or you can lock in your profits using simple sell rules.

I wish all choices in life were that easy!

Don't Forget the Opportunity Costs

Holding a stock as it sheds a large percentage of its value does more than just hand you a big loss. You also have to consider the opportunity costs.

- **Your goal is to compound profits, not recoup losses.**

Let's say you made a 25% gain on a \$10,000 position. You'd now have \$12,500 to invest in another stock. If you make 20% on your next trade, you now have \$15,000—a total gain of 50%. That's the beauty of compounding.

But . . . you'd be in a very different position if you ignored *both* the 20%–25% profit-taking rule and the 7%–8% sell rule and took a 50% loss before you sold. You'd now only have \$5,000 to invest (a 50% loss)—and you'd need a 100% gain just to recoup your losses. Investors who do that take a loss *and* forfeit the opportunity to compound good gains.

- **The big money is made in the *new* crop of leading stocks.**

If only 1 in 8 former leaders comes back to lead again, what does that tell you? That in every bull market cycle, *new* names appear. And these new leaders—not the old ones—are the stocks most likely to double or triple in price.

So if you take a big loss in a former leader and continue to hold it, it could take *years* before you recoup that loss—if you *ever* do. And in the meantime, you'd be missing out on the huge profits the current leaders are serving up.

That's an opportunity cost none of us can afford to pay.

Consider the case of DryShips we saw earlier: From November 2006 to November 2007, the stock soared from around \$14 to \$131—an 835% gain in just one year. Even if you only got a small piece of that move, it could still mean a big profit.

But if you kept holding that stock as the financial crisis pushed the market into a sharp downtrend, you would have seen DryShips drop from \$131 to under \$2 over the next 5 years.

That loss is painful enough, but it gets worse. Investors who sat there holding DryShips would have missed all the *new* big winners that emerged in the 2009 bull—stocks that surged 100%, 200% or much more: Chipotle Mexican Grill, Apple, Ulta Beauty, Lululemon Athletica, Watson Pharmaceuticals, Tractor Supply, Ross Stores, Dollar General, Panera Bread, Intuitive Surgical, SolarWinds, Rackspace Hosting, Priceline.com, TDG, Mellanox Technologies, Michael Kors, 3D Systems and dozens more.

All of this just brings us back to that one simple concept: Make money in an uptrend by following the Buying Checklist. Then lock in those profits—and cut short any losses—when the market weakens by using the Selling Checklist.

That's how you make money in stocks.

How to Properly Apply the 7%–8% Sell Rule

Note that this rule is only triggered when a stock drops 7%–8% below *your purchase price*. For example, if you buy a stock at \$100 a share and it drops to \$92, sell.

But let's say you buy a stock at \$100, and it goes up to \$150. If it then drops 8% from there to \$138, that does *not* trigger this sell rule.

Start Out Right: Stick to the Plan

As I said at the very beginning of this book: Keep it simple. Don't overcomplicate what you need to do.

If you regularly check current market conditions and follow both the *offensive* and *defensive* sell rules in the checklist, you'll be in good shape to make good money.

And if you find it hard to sell when your stocks trigger these rules, or if you can't watch the market during the day, set up trade triggers with your broker *ahead of time* (Chapter 4). It's a good way to make sure you stick with the selling game plan and stay profitable and protected.

Check the Chart for More Warning Signs and Sell Signals



See how to spot other signs of weakness in Chapter 6, "Don't Invest *Blindly*: Use Charts to See the Best Time to Buy and Sell."

• ACTION STEPS •

Here are some quick *To Dos* to learn more about how to apply the rules on the Selling Checklist. To take these steps, visit www.investors.com/GettingStartedBook.

1. Use the Selling Checklist to check current market conditions and any stocks you own right now.
 - Is the market currently in an uptrend—or correction?
 - Are you up 20%–25% on any of your stocks—or nearing a 7%–8% loss?
2. Watch a short video on how to apply the 7%–8% sell rule.

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• CHAPTER •

Don't Invest *Blindly*: Use Charts to See the Best Time to Buy and Sell

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Why Use Charts?

“Just as doctors would be irresponsible not to use X-rays on their patients, investors are just plain foolish if they don’t learn to interpret the price and volume patterns found on stock charts.”

—WILLIAM J. O’NEIL

I couldn’t imagine making any buy or sell decision without first checking the chart. It would be like driving blindfolded: If I can’t see what’s going on around me, how do I know if I should hit the gas—or the brakes?

Charts truly are *that* important. And here’s why.

Think back to one of the “Big Rocks” we’ve been discussing:

Buy stocks being heavily bought by institutional investors. Avoid those they’re heavily selling.

We spent an entire section hammering home that key point: Fund managers and other professionals ultimately determine the fate of *your* stocks.

By using charts, you can literally see what these big investors are doing. And it’s not hard to do once you demystify what’s in a chart and understand one simple fact . . .

Charts Tell You a “Story”

When I was starting out, charts seemed overly “technical” to me. My epiphany came when I finally realized all those lines and bars aren’t so mysterious after all. They actually do just one simple thing: They tell you a story. As you’ll soon see, charts paint a behind-the-scenes picture of what is *really* going on with the stock:

- Are fund managers enthusiastically buying? Or are they heading for the exits, unloading shares as fast as they can?
- Despite some recent price declines, have institutional investors actually been stepping in to support the stock and pick up more shares—meaning it could be heading for even bigger gains?

- How have big investors reacted to recent news about the stock? Did they *sell* even though the news was *good*? Or did they *buy* more shares even though the news was *bad*?

By understanding that story and looking for certain signals, you'll know if now is a time to buy, sell or hold.

Start with the Basics

At workshops and IBD Meetup events, I've worked with countless investors looking at stock charts for the very first time. From that experience—and my own—I've boiled down the basics of chart-reading into a few key concepts.

The goal here isn't to get into *advanced* techniques. It's about getting started: By the end of this chapter, you'll have everything you need to run your stocks through the “Chart Analysis” items on the buying and selling checklists.

Here's how we'll do that one step at a time:

- **Chart-Reading 101:** You'll learn what's in a chart and 3 ways to “see” if institutional investors are heavily buying or selling a stock.
- **3 Telltale Patterns That Launch Big Moves and Alternative Buy Points:** You'll see that spotting “bases” and “buy points” is really not that hard—and can be immensely profitable.
- **Using Charts to Go Through the Checklists:** I'll show you how to start using the “Chart Analysis” items on the buying and selling checklists to help capture—and keep—solid gains.

Stick with It

Even if it seems a little confusing at first, don't give up. Watch the videos and take the Action Steps. You'll soon get the hang of it and realize that chart-reading truly is a lifelong money-making skill.

As Bill O'Neil has said: **“Fortunes are made every year by people who learn to properly read charts.”**

Improve Your Chart-Reading with the Simple Weekend Routine

As you're getting started, do the **Simple Weekend Routine** (see Chapter 4).

- Check the *IBD 50* and *Your Weekly Review* for highlights of stocks near potential buy points.
- Pull up a chart on Investors.com. Can you spot the pattern and buy point?

It's a good way to improve your chart-reading skills and build a timely watch list at the same time.



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See the Routine in Action



Watch a short video at www.investors.com/GettingStartedBook.

Chart-Reading 101: What's in a Chart?

To understand the “story” a chart reveals, we’ll cover 3 basic concepts:

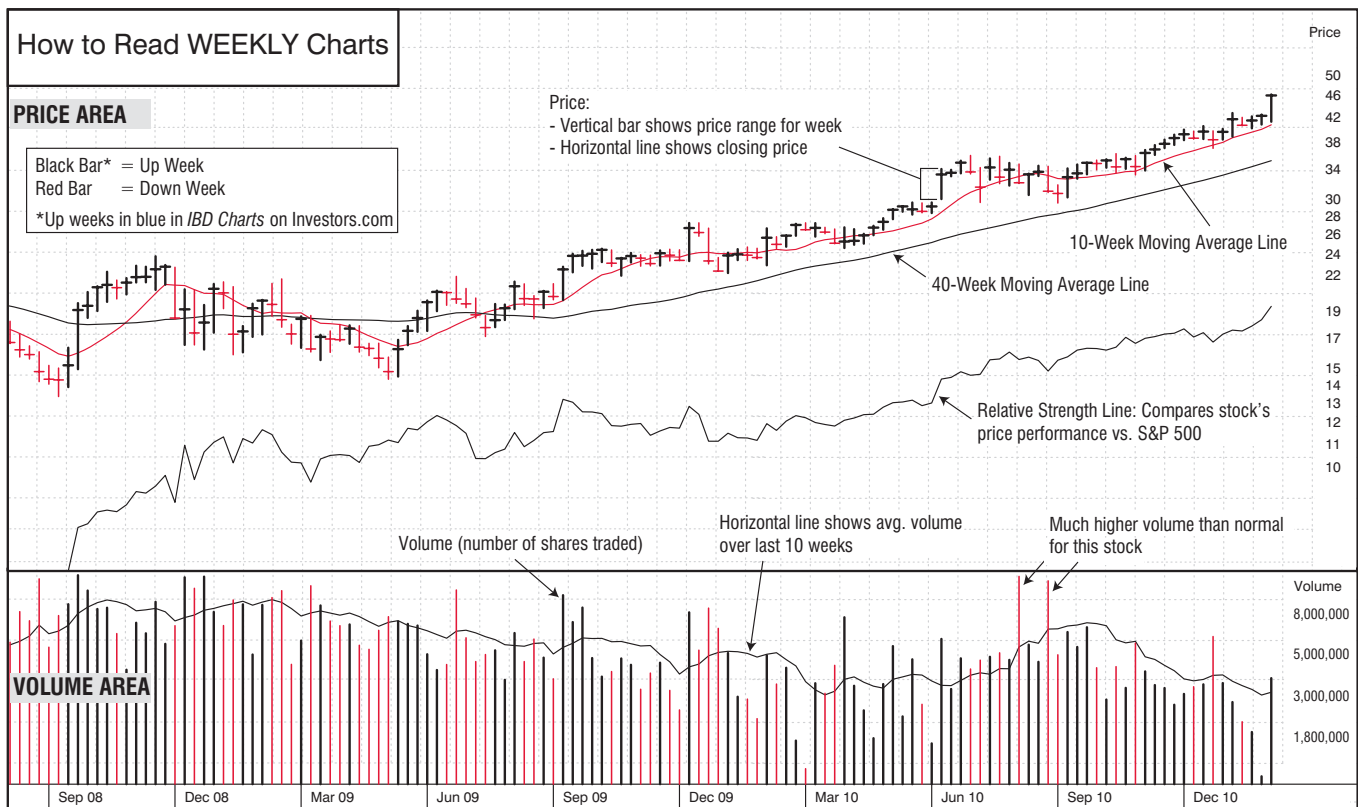
- What’s the trend?
- Always check price *and* volume.
- Is the stock finding support or hitting resistance?

Once you understand those, all the other things on the buying and selling checklists—chart patterns, buy points, sell signals, etc.—will fall into place.

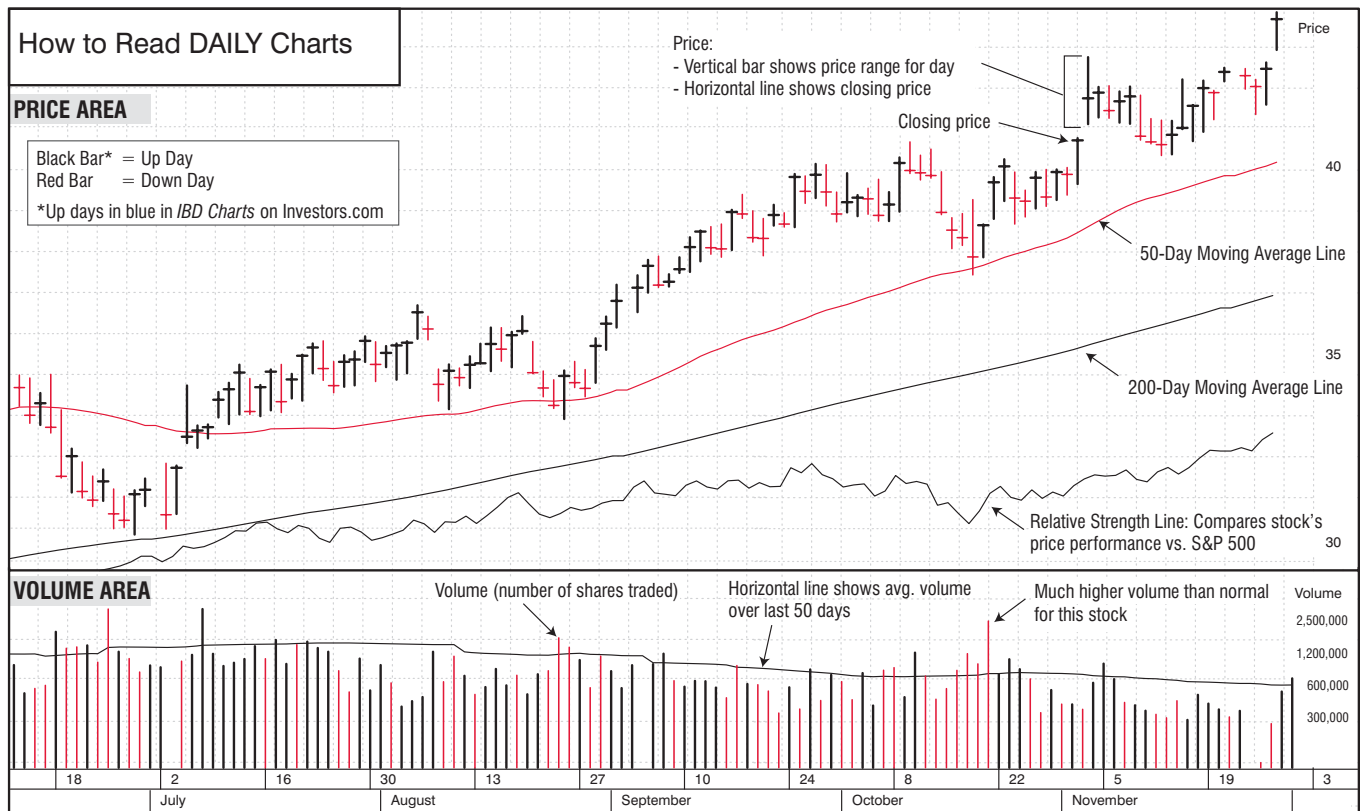
But first, we need to answer an even more basic question: What’s in a chart?

Basic Elements of Daily and Weekly Charts

Important: Be sure to use *both* daily and weekly charts. The weekly chart helps you see longer-term trends, while the daily chart helps you pinpoint specific buy and sell signals. (Throughout this book, each chart is identified as being either weekly or daily in the top left corner.)



Weekly charts give you a longer term perspective and help you see the stock's underlying trend.



Daily charts help you spot specific buy points and early warning signs.

- **Black bars vs. red bars:** IBD charts are color-coded to make them easy to read: Black (blue on Investors.com) indicates the share price for that day or week closed higher. Red means the share price closed lower.
- **Long price bars vs. short price bars:** In the price area (upper half) of the chart, the bars may be long or short. The bars show the price range for that day or week. So a longer price bar indicates a wider swing in price, while a shorter price bar means the stock traded in a tighter range.
- **Above-average vs. below-average volume:** In the volume area (lower half) of the chart, you'll see a black horizontal line. That shows the average volume (i.e., the number of shares traded) for that stock over the last 50 days on a daily chart or 10 weeks on a weekly chart.

If the volume bar is above that line, it means volume for that particular stock was *above* average for that day or week. As you'll soon see, sharp spikes in volume reveal what institutional investors are really up to, and this line helps you see if volume is unusually heavy or light.

- **Moving average lines:** These horizontal lines, found in the price area (upper half) of the chart, simply track the average share price over the specified time period.

On a weekly chart, the red horizontal line shows the 10-week moving average, and the black line shows the 40-week moving average. On a daily chart, the red line tracks the 50-day moving average, while the black line tracks the average share price over the last 200 trading days.

You'll soon understand why it's extremely important to see how a stock behaves when it is trading around these benchmark lines.

- **Relative strength line:** In the price area (upper half) of the chart, the horizontal relative strength line compares the share price movement over the last 52 weeks of that particular stock to the price movement of the S&P 500.

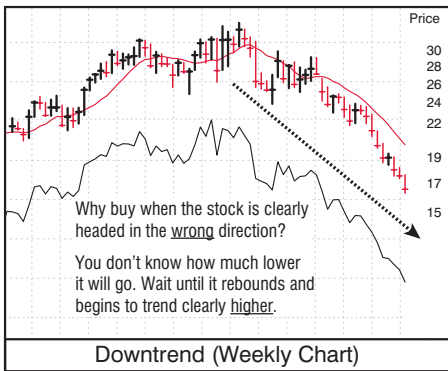
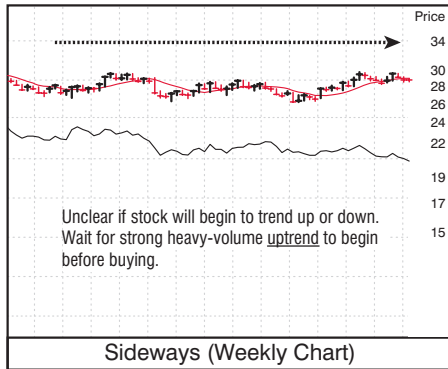
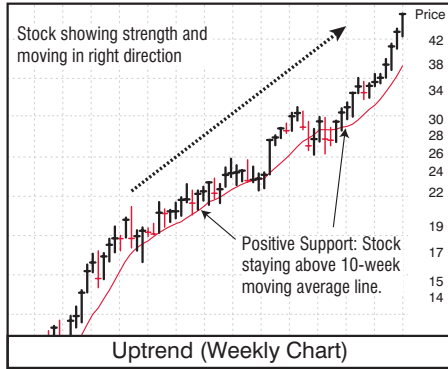
If the line is trending up, the stock is outperforming the S&P 500—a positive sign that tells you that stock is a market leader in terms of price action. If the relative strength line is trending down, it tells you the stock is lagging the overall market.

Next up: Let's look at 3 ways you can tell what “story” the chart is telling—and see if institutional investors are heavily buying or selling.

Chart-Reading 101: What's the Trend?

This “story” is fairly obvious, but very important: Which direction is the stock heading in right now?

There are basically just 3 possibilities.



You want to buy a stock when it's showing strength, not weakness. "Strength" means the stock is trending higher and finding support at key moments—both signs that institutional investors are buying shares.

Look at the example of a downtrend. Does that look like strength or weakness? How much lower will that stock go before it finds an area of support (a "floor") and starts coming back up? Will it *ever* come back up? No one knows! It might start a big run tomorrow; it might keep going lower.

That's the point: **Why take on all that risk and uncertainty when you don't have to?**

Don't get suckered into "bargain hunting" for beaten down stocks that are on the decline. Remember what we learned earlier: **Stocks hitting new lows tend to go lower. Stocks hitting new highs tend to go higher.**

So only buy stocks that are *already* showing strength and moving in the right direction—up!

Chart-Reading 101: Always Check Price *and* Volume

Some people write off charts as too complicated—or as some type of modern day fortune-telling tea leaf. But the fact is, *charts are nothing more than a visual representation of price and volume action.*

And the picture a chart paints is very revealing: That *combination* of price *and* volume clearly shows you what big investors are up to.

Here's how it works . . .

Institutional investors are like the proverbial elephant in the bathtub—they can't hide. When they jump in or get out, you can't miss it *if you use charts.*

That's because a stock chart will clearly show any significant spike (or drop) in *volume* as the share price changes. That change in volume tells you how serious the buying or selling by institutional investors actually is.

The scenarios in the following charts give you a *basic* look at how price and volume work together. Other factors may come into play, but for now these outline the key concepts to keep in mind.

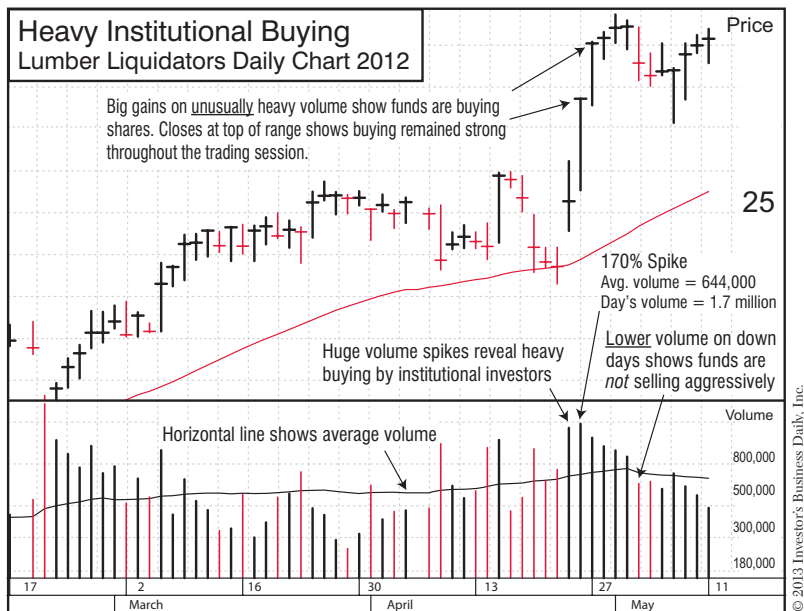
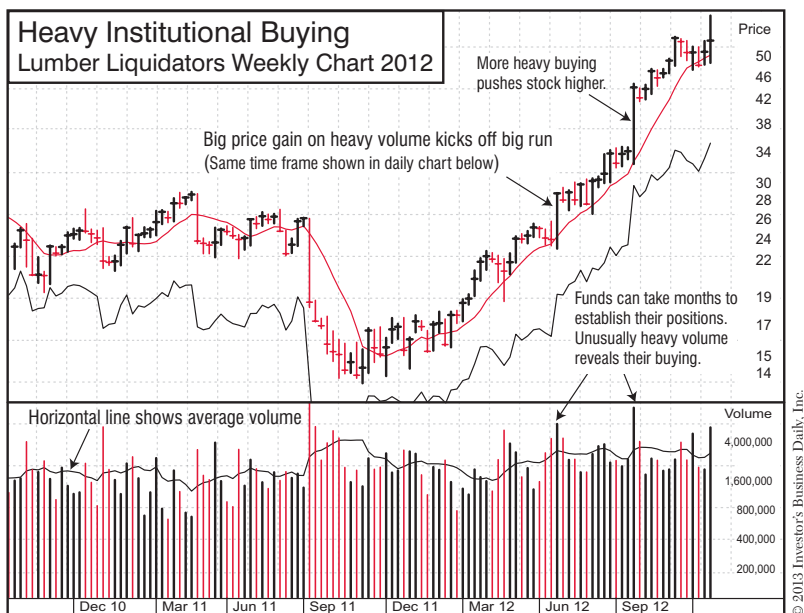
Now *That's* Unusual!

As you go through these scenarios, understand that you're looking for *unusual* volume—either unusually heavy or unusually light.

For example, if a stock that normally trades 1 million shares a day suddenly trades 2 million, you need to pay attention. That's not your Uncle Fred buying or selling 100 shares. That's *institutional* trading—and you have to find out what “story” it's telling.

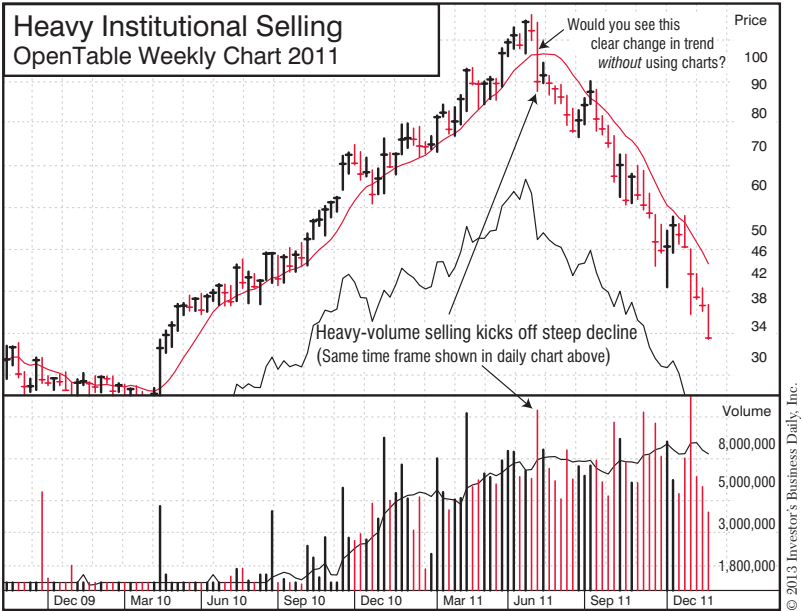
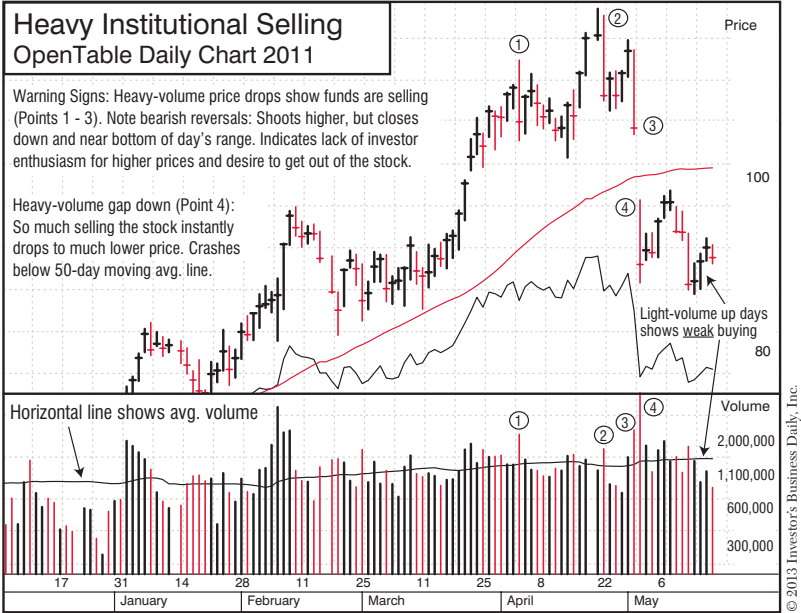
Take a few minutes to carefully review the notes inside the following charts. Pay special attention to the spikes in volume that are highlighted and the “story” they reveal about what fund managers and other big investors are up to. Knowing how to spot *unusual* volume—and understanding what it means—will be key to your investing success.

Institutional Buying: Big Price Gains on Unusually Heavy Volume



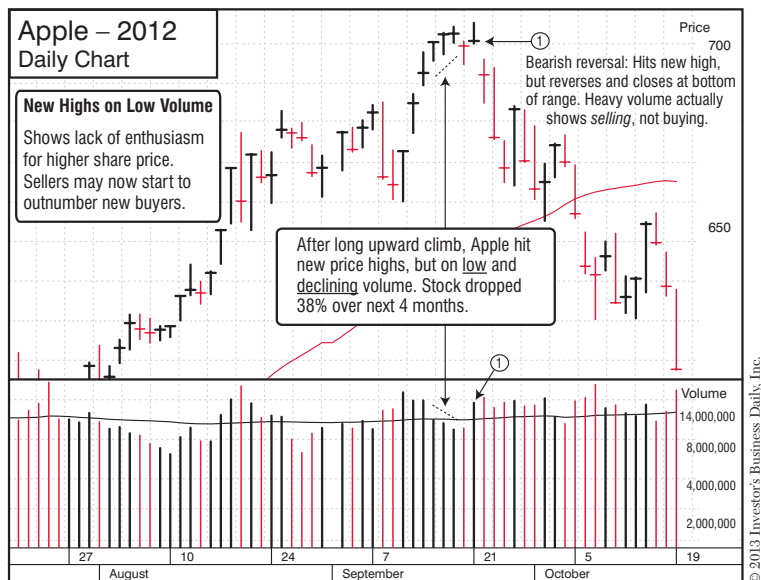
Big price gains on unusually heavy volume show institutional investors are buying aggressively. It's also a bullish sign when the stock's *closing price* is in the *top* part of the range for that day or week.

Institutional Selling: Big Price Drops on Unusually Heavy Volume



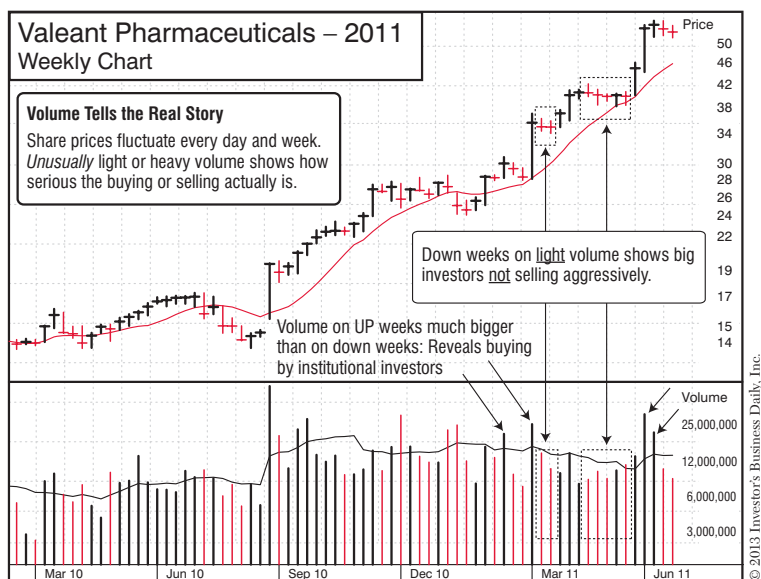
Big price drops on unusually heavy volume show institutional investors are selling aggressively. It's also a bearish sign when the stock's closing price is in the *bottom* part of the range for that day or week.

Price Gain on Light Volume



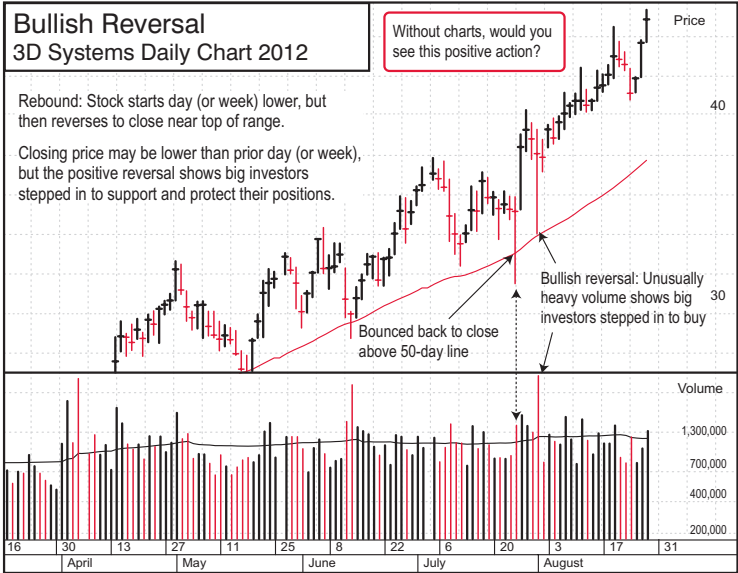
Light volume on up days or weeks could mean big investors are *not* enthusiastic about the stock. May be a sign the stock will start to sell off.

Price Drop on Light Volume

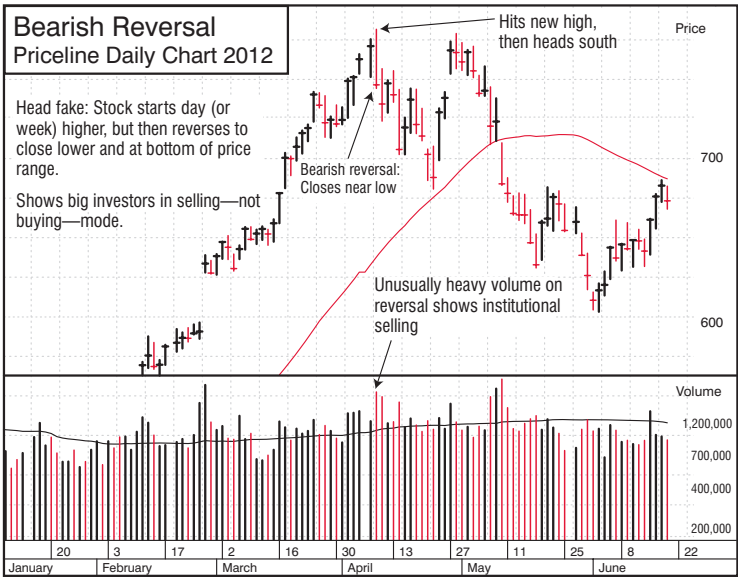


Light volume on down days or weeks means big investors are sitting tight and not selling aggressively.

Bullish vs. Bearish Reversals



Bullish reversal shows investors stepped in to support the stock.



Bearish reversal on heavy volume: Shows big investors used initial price gain as opportunity to sell. Rather than support the stock and push it higher, they sold and pushed it down.

And the Survey Says . . .

Here's another way to think about volume.

Let's say you run a small clothing store and you have to decide what clothes to buy for the summer season. In a trade magazine, you see a survey that says "70% of women plan on buying a red swimsuit this year." Your initial reaction might be, "Wow, I'd better fill my shelves with red swimsuits."

But then you dig a little deeper and find out there were only 10 respondents to that survey!

Would you still base your inventory on the opinions of 10 people? Of course not. Now, if the survey was properly sampled, professionally conducted and had 10,000 respondents, you might lend the results more credence.

It's the same with volume. If a stock's share price goes up 2% one day, that doesn't tell you all that much—until you also check the volume. Was it unusually heavy? Or was volume well *below* average?

Without that information, there's no way to understand what the price change actually means. Are big fund managers showing real enthusiasm and heavily buying the stock? Or is it just a head fake?

It still amazes me that so many financial news programs and publications will just say "IBM closed 1% higher today" and say nothing about the *volume*. It's essentially the same as a pollster saying "7 out of 10 women love red swimsuits" without explaining how many people they surveyed (i.e., the volume) to come to that conclusion.

They say real estate is all about "location, location, location." You'll find that when it comes to using charts to see the right time to buy and sell a stock, it's all about "volume, volume, volume." So to understand what the changes in share price are *really* telling you, ***always check the volume.***

Chart-Reading 101: Is the Stock Finding Support or Hitting Resistance?

Now that you have a basic sense of the important relationship between share price and trading volume, let's take a look at another key chart-reading concept: Support and resistance.

Think of it like a floor (support) and ceiling (resistance).

The chart patterns and “buy points” we'll discuss are all based on this simple idea: To make sure the stock is more likely to go up than down when you buy it, first make sure it has already established a solid floor (support) from which it can move higher. Then wait for the stock to show real power by smashing through the ceiling (resistance), clearing the way for a new upward move.

Here again, let's go through some common scenarios so you understand the basic concepts.

Turn Up the Volume

Be sure to pay attention to changes in volume in these scenarios. For example, when a stock is punching through an area of resistance, you want to see *unusually heavy* volume kick in. That shows institutional investors are buying enthusiastically and aggressively. Light volume would show more hesitation and a lack of conviction—which could mean the stock will fail to climb higher and soon fall back below that same area of resistance.

Support or Resistance at 10-Week or 50-Day Moving Average Line

It's very important to watch how your stock behaves around the moving average lines—particularly the 10-week line on the weekly chart and the 50-day line on a daily chart. The reason is simple: Professional investors use these lines as key benchmarks. So you can see if fund managers and other big players are supporting or selling the stock by watching how it behaves around those key moving average lines.

- **Support:** If institutional investors still have a positive outlook on the stock, they'll often step in to buy more shares and protect their positions when the stock pulls back to or dips below the moving average line.

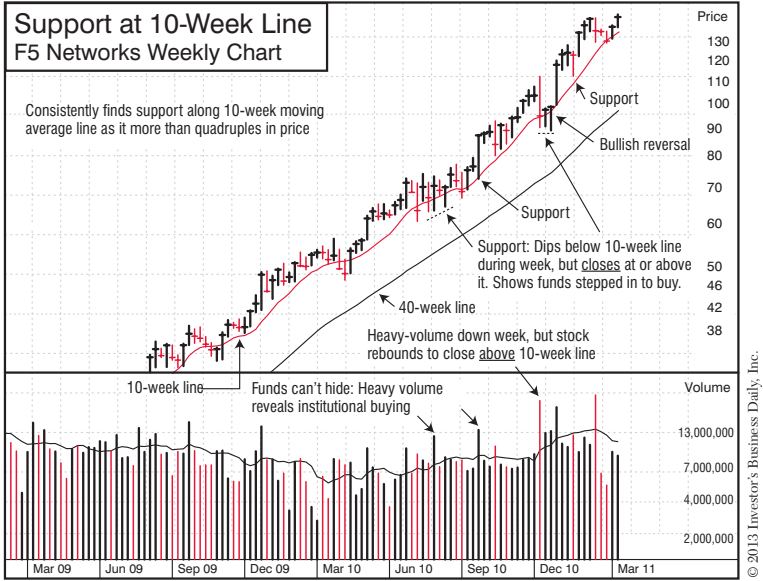
In that scenario, you'll typically see the stock pull back to the 50-day or 10-week line on *light* volume (showing that institutions are *not* selling aggressively), then bounce back above that line on *heavy* volume (showing that fund managers are stepping in to buy more shares).

- **Sell-off:** If the stock fails to find support at the benchmark lines and crashes below them on heavy volume, what does that tell you? That big investors may now be less interested in shoring up their positions and more interested in just getting out of the stock.

Again, the key is to watch the *volume*: If trading is particularly *heavy* as the stock breaks through the moving average line, that's a definite warning sign. If volume is *light*, it could mean the selling is less serious.

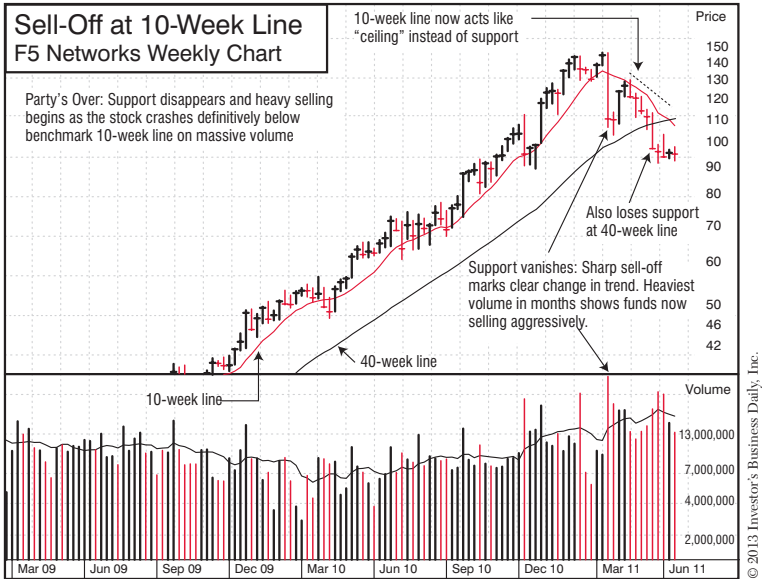
As you can see in the following chart for F5 Networks, it's not unusual for a stock to move below the 10-week or 50-day moving average line for a few days or weeks, even as its overall trend is still headed higher. So a drop below one of these key benchmark lines does not mean you should automatically sell the stock. We'll talk more about that and specific sell signals in the Selling Checklist.

Support at 10-Week Moving Average Line



Looking for support at the 10-week and 50-day moving average lines can help you hold a stock for potentially bigger gains.

Sell-Off at 10-Week Moving Average Line



Watch out when a stock crashes through and closes sharply below the 10-week line on heavy volume. It could mean more selling is on the way.

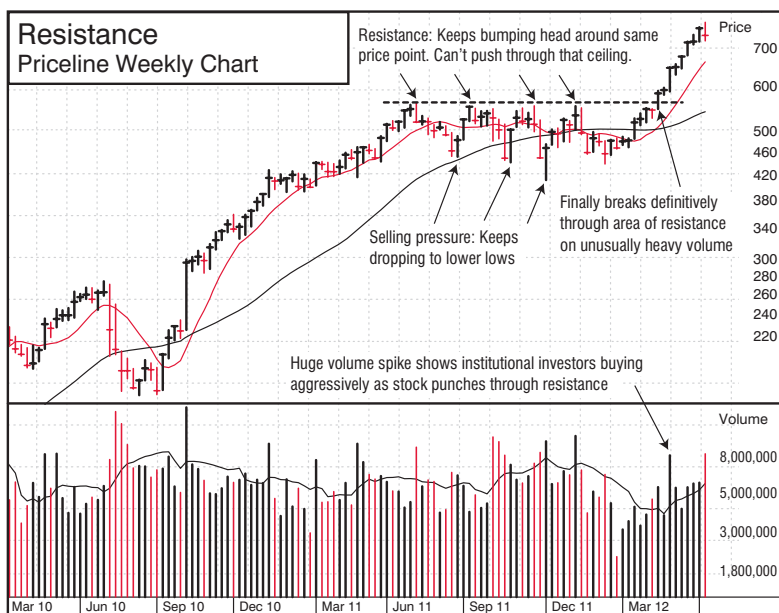
Support or Resistance at Specific Price Points

In addition to watching how a stock behaves around the moving average lines, you also want to look for signs of support and resistance at certain price areas. This is a vital part of understanding how and why the telltale chart patterns we'll discuss later help you pinpoint the best time to buy a stock.

And after you buy, this concept will also help you know whether you should *hold* the stock because it's building "stepping stones" by finding support at key areas—or if it's time to sell because it crashed right through the "floor."

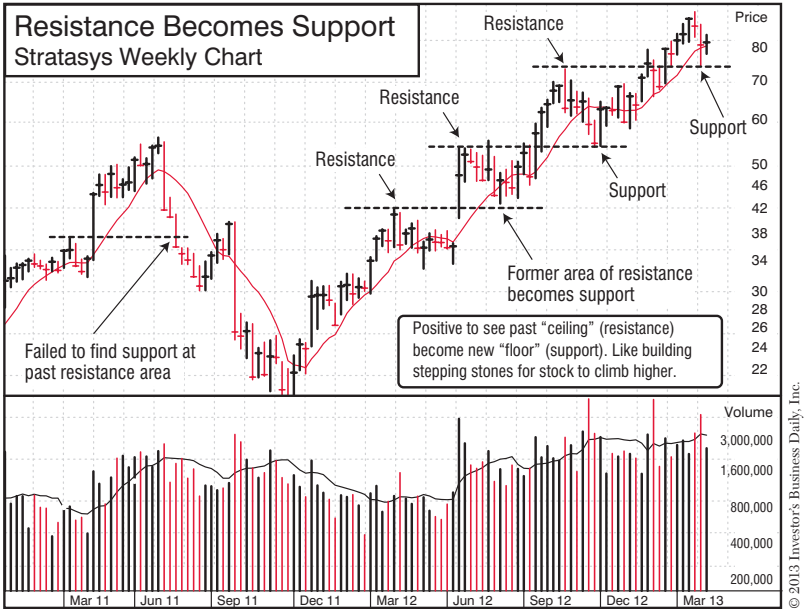
The following examples show you what support and resistance look like on a chart. As you look at the notes in each example, pay particular attention to that all-important relationship between price and volume.

Resistance at Key Price Points



**An area of resistance is a key testing ground:
Make sure the stock can punch through it on *heavy* volume.**

Former Area of Resistance Becomes Area of Support



Stepping stones: Watch to see if a prior area of resistance becomes an area of support. That can help you hold a stock as it climbs higher, one step at a time.

Next up: Let's use the 3 concepts we just learned to spot the telltale patterns that launch big price moves.

3 Telltale Patterns That Launch Big Moves

As a political history buff, I'm always struck by how little things change from decade to decade, even century to century. New players and issues come and go, but the core arguments and debates remain essentially the same. Why? Because it all comes back to human nature, and human nature never changes.

It's the same with the stock market. And if you understand and accept human nature for what it is, the seemingly chaotic behavior of the market will make more sense—and *you* can make more money.

I'm bringing this up because as we go through the 3 main patterns that alert you to a potential big move, I want you to keep in mind that these are not random shapes on a chart. They're a reflection of human emotions: Hope, fear and greed. And just like the price and volume action, they have a story to tell.

The Patterns Don't Change

Because human nature doesn't change, the shapes of these telltale patterns also remain the same.

At the beginning of *How to Make Money in Stocks*, Bill O'Neil showed the charts of 100 of the top-performing stocks over the last 100+ years. Whether it was General Motors in 1915, Coca-Cola in 1934 or Priceline.com in 2006, those patterns (also known as "bases") were identical. You'll find the same shapes today and the same patterns decades from now.

By learning to spot these bases, you'll be able to get in early on the best stocks—year after year.

Think of a chart pattern like a "launching pad": It's the *starting point* for the stock's big new move. So once you learn to spot these 3 common bases, you'll be right there for "takeoff." That's why it's so profitable to use chart patterns to time your buys.

As I said before, it takes some time and effort to read charts properly. But stick with it. It's not as hard as you may think, and as the table below shows, the payoff can be life-changing.

How These Telltale Patterns Launched Major Gains

Company	Year Run Started	Type of Pattern	Subsequent % Gain
Apple	2004	Cup-with-Handle	1,528% in 199 weeks
Intuitive Surgical	2004	Cup-with-Handle	1,826% in 180 weeks
CME Group	2005	Double Bottom	224% in 113 weeks
Deckers Outdoor	2007	Flat Base	173% in 46 weeks
Baidu	2009	Cup-with-Handle	401% in 93 weeks
Chipotle Mexican Grill	2010	Cup-with-Handle	186% in 84 weeks
Lululemon Athletica	2010	Double Bottom	196% in 44 weeks
Lumber Liquidators	2012	Cup-with-Handle	167% in 48 weeks
Regeneron Pharmaceutical	2012	Cup	136% in 45 weeks
3D Systems	2012	Cup	178% in 40 weeks

We'll talk first about the 3 main patterns that launch the big gains of virtually all big winners: **Cup-with-handle**, **double bottom** and **flat base**. Once we see how to spot the basics, we'll also take a look at some additional clues you want to keep an eye on in the "Go Beyond Just the Shapes" section of this chapter.

Then we'll go over 2 alternative buying opportunities that can deliver some nice gains: **3-weeks tight** and a **pullback** to the 50-day or 10-week moving average line.

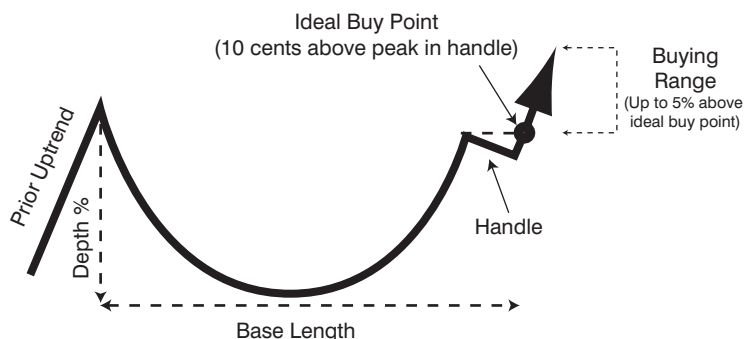
There are other patterns and price actions to look for, but these are by far the most common and, frankly, the most profitable. So as you're getting started, keep it simple and just focus on these.

As we go through these patterns, keep in mind what we just discussed about the "story" that *price and volume* and *support and resistance* reveal. That provides the backstory for what's going on in these chart patterns and why it's important.

Cup-with-Handle

Most Common and Profitable Pattern

- Winning stocks often *start* their big runs by forming this pattern
- Resembles a teacup viewed from the side



What to Look For

How do you find winning stocks in the *early* stages of a major move? Learn to spot a cup-with-handle. Year after year, the biggest winners often launch their runs as they break out of this same pattern.

We'll go through several examples below, but first let's see what to look for in a proper cup-with-handle.

As we do that, we'll also take a look at what "story" the chart is telling as the base forms. That will help you understand how chart patterns and buy points work—and see how emotions and human nature play a big role.

Watch Your Chart-Reading Skills Grow with IBD TV



Tune in to free *Daily Stock Analysis* and *Market Wrap* videos to see how to analyze charts—and build a timely watch list. See how at www.investors.com/GettingStartedBook.



Prior uptrend: 30% or more

To form a proper “base” or chart pattern, you have to have a prior uptrend. The idea behind a base is that after making a decent run, the stock is now digesting those gains as it catches its breath in preparation for an even higher climb. In other words, it’s forming the “stepping stones” we discussed in the section on support and resistance.

Backstory

The prior uptrend typically happens when the overall market is moving higher. When that uptrend starts to slip into a correction, even the top CAN SLIM® stocks will likely pull back and start forming a new base.

When that happens, savvy investors who got in *early* on that uptrend will start to cash in their gains. You’ll probably see your 20%–25% profit-taking rule kick in around this time.

But it’s a very different story for people who did *not* get in early and ended up buying at the end of that prior uptrend. Because they didn’t have proper buy rules like the ones in the Buying Checklist, they bought just as the overall market weakened and the stock itself started to decline. And since they probably don’t have proper sell rules either, they’ll soon be sitting on a big loss.



Base Depth: 15%–30%

The depth of the base—measured from the peak on the left side of the cup to the lowest point (the “bottom”) of the cup—should be between 15%–30%. In a severe bear market, the depth may be 40%–50%. As a general rule, look for stocks that held up relatively well during the market correction. So if one stock on your watch list dropped 35% while another’s base depth is only 20%, all else being equal, the stock with the 20% decline could be forming a stronger base.

Backstory

Remember those folks who bought too late in the prior uptrend? They’re now sitting on significant losses, just hoping and praying to somehow get back to breakeven.

In the meantime, the stock has found a bottom and is now starting to form the right side of the cup. Why did that happen? Because *institutional investors* stopped selling and started buying. That's what stops the bleeding and allows the stock to start moving higher again.



Base length: At least 7 weeks

- The first down week in the base counts as Week #1

The minimum length for a cup-with-handle is 7 weeks, but some can last much longer—several months or even a year or more. Be wary of any pattern that has the *shape* of a cup-with-handle but is only, say, 5 weeks long. That's typically not enough time for the stock to consolidate the prior gains, and that base has a higher chance of failing.

Backstory

The length of a cup-with-handle is usually affected by the length of the general market correction. In a long, deep bear market, you'll likely have a lot of long, deep cup-with-handle formations. And in shorter and shallower interim corrections, you'll see the bases mirror that same action.



The Handle

- Volume in handle should be *light*
- Depth of the handle should be around 10%–12%
- Should form in *upper* half of base
- Peak of handle should be within 15% of old high on left side of cup

The handle should be a *mild* pullback on relatively *light* volume. It's a “shakeout” of weaker holders—those not committed to holding the stock longer term. A sharp decline of more than 12%–15% on *heavy* volume could indicate a more serious sell-off that might prevent the stock from launching a successful move.

The handle should form in the *upper* half of the base. If it begins forming too soon (i.e., in the lower half of the base), it could mean institutional buying, right now, is not as strong as it needs to be to push the stock higher.

“N” Also Means “New High”

As we saw earlier, the “N” in CAN SLIM stands for a “new” product or industry trend, but it also refers to a new 52-week price high.

For each of these telltale patterns—cup-with-handle, double bottom and flat base—a key requirement is that the stock be at or near a new high as it breaks out. That’s a sign of strength—and an important reminder of this historical market fact:

- Stocks hitting new price *highs* tend to go *higher*.
- Stocks hitting new price *lows* tend to go *lower*.

So save the bargain bin, clearance sales for the shopping mall! When it comes to buying *stocks*, focus on those showing strength as they climb into new high territory and break out of a sound chart pattern.

Backstory

Who are the weaker holders getting shaken out in the handle? Those folks who bought late at the end of the prior uptrend and suffered big losses. Getting a *profit* is no longer their goal. They just hope to recoup some of their losses. So as the stock nears that old high—and the weaker holders’ breakeven points—they start to sell.

Here’s why that shakeout is healthy: If you have a lot of “weak holders” in a stock, whenever the share price rises, they jump in to sell, which pushes the price back down. Once they’re out of the picture, it’s easier for the stock to move higher.

And what about the big investors who’ve been picking up shares as the stock formed the right side of the cup?

They’re more committed and are holding onto their shares. That’s why the volume in the handle is *light*: Only the weak holders are selling. The big institutions are sitting tight in expectation of a new upward move.



Ideal buy point

- 10 cents above the peak in the handle
- Buying range: Up to 5% above ideal buy point
- *Always buy as close as possible to the ideal buy point!*

If the peak in the handle is, say, \$30, then you add 10 cents to get the *ideal buy point* of \$30.10.

The *buying range* would be from \$30.10 to \$31.60—5% above the ideal buy point.

You want to buy as close to the ideal buy point as possible. If you're not able to watch the market during the day, you can set trade triggers ahead of time (Chapter 4).

Once a stock climbs more than 5% above the ideal buy point, it's considered "extended" or beyond the proper buying range. **Don't buy extended stocks.**

Stocks often pull back a bit after a breakout. If you buy too late, there's a higher chance you'll get "shaken out" of the stock because it triggers the 7%–8% sell rule we covered in the Selling Checklist.

Backstory

Note how the peak in the handle is the most recent area of *resistance*: The stock bumped its head against that ceiling and fell back down.

So that's our new testing ground—and that's why we use that to determine the buy point.

Can the stock punch through that area on heavy volume? That would mean institutional investors are enthusiastically buying the stock and willing to push it higher.

For all bases, we add 10 cents to the most recent area of resistance to determine the ideal buy point. That's just to make sure the stock is truly punching through that resistance and not just bumping up against it.

☑ *Volume on day of breakout: At least 40%–50% above average*

On the day a stock breaks past its ideal buy point, volume should be at least 40%–50% higher than normal for that stock. That shows strong institutional buying. On many breakouts, you'll see volume spike 100%, 200% or more above average. *Light* or below-average volume could mean the price move is just a head fake, and the stock is not quite ready for a big run.

Be on the Lookout During Earnings Season



Whether it's from a cup-with-handle or other pattern, many breakouts happen when companies release their latest quarterly earnings report. So stay alert—but also cautious: The stock may *drop* sharply instead. See Chapter 3 for more on how to handle earnings season.

Why Not Buy at the *Bottom* of the Cup-with-Handle?

Hindsight is indeed 20-20.

After a stock has completed the pattern, it's easy to *retroactively* say, "I would have made more money if I'd bought at the bottom." That's true—that one time—in hindsight. But when the base is still forming, how do you know if the stock has really hit bottom?

If you try to buy *before* the pattern is complete, you're just taking on unnecessary risk.

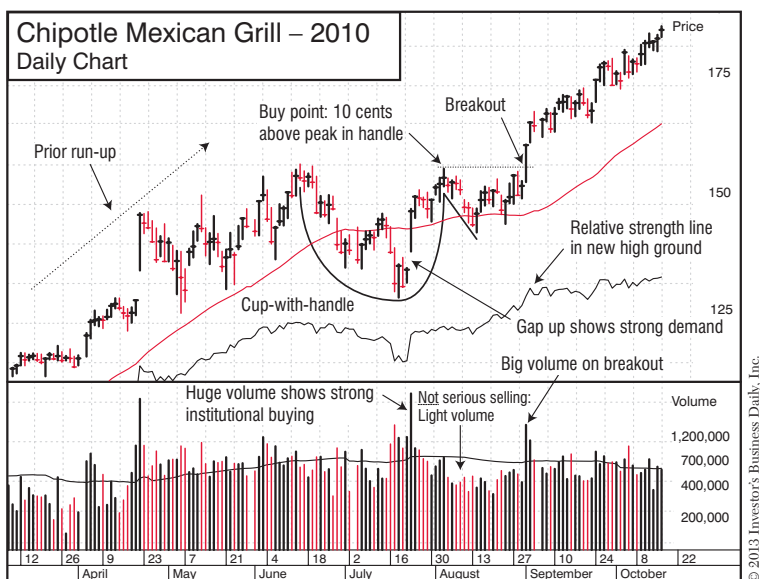
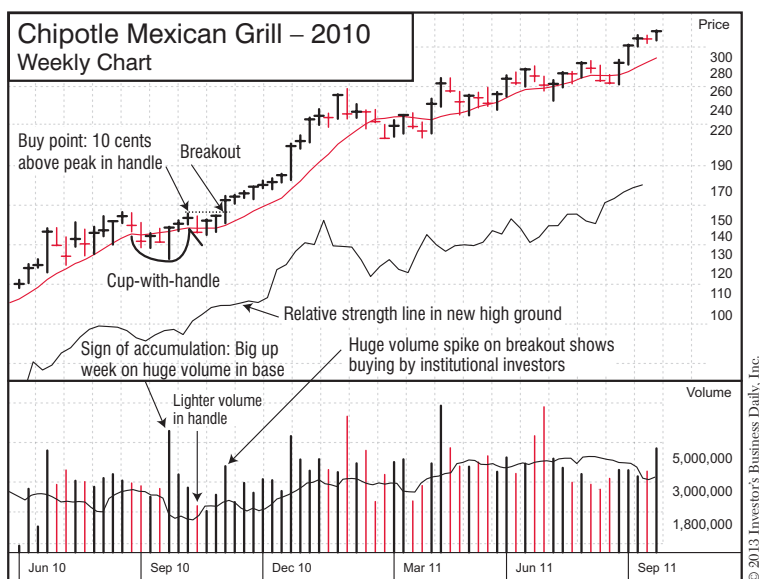
If you wait for the stock to finish the base and break out on heavy volume, you *dramatically* reduce your risk and still leave plenty of potential for *major* gains.

Launching Big Gains with the Cup-with-Handle

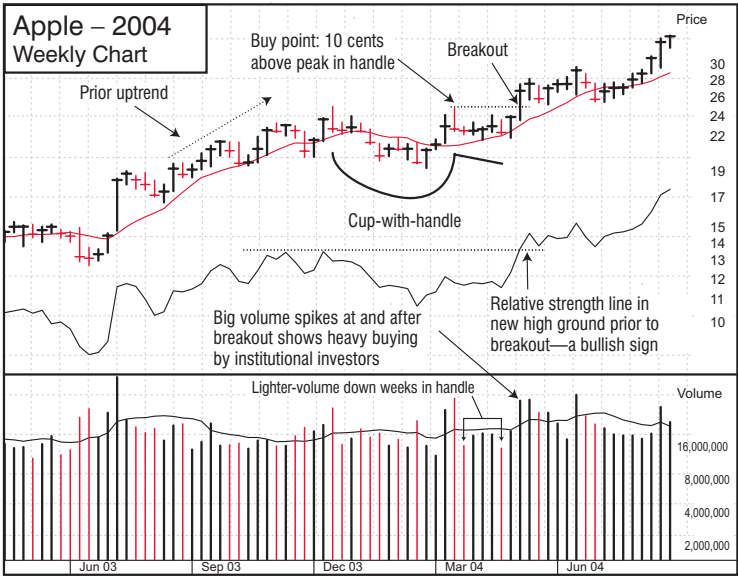
Below are examples of winning stocks that launched big runs from a cup-with-handle pattern. Both the daily and weekly charts are included. The weekly charts show the longer term trend, while the daily charts show the action on the actual day of the breakout. Be sure to use both!

Don't rush through the following examples. Take some time to study the notes and see how these patterns met the key requirements of a proper cup-with-handle. And as always, pay close attention to the price and volume action within the base, and see how the concept of "support and resistance" comes into play.

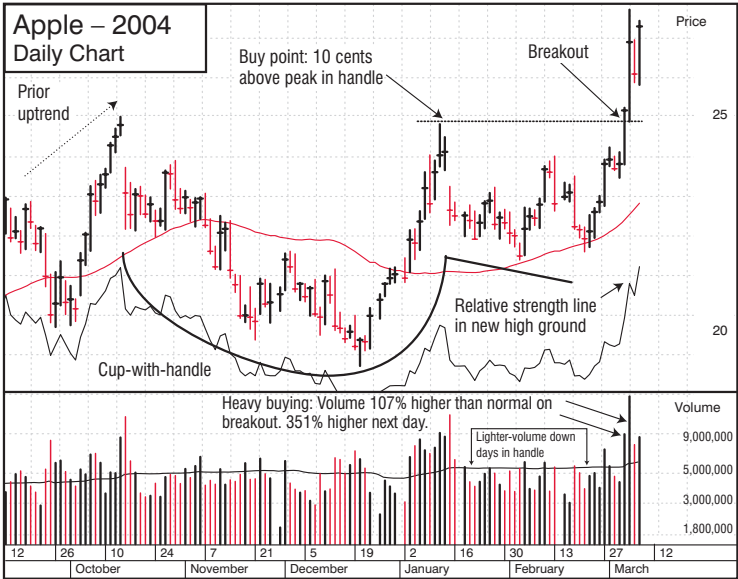
Also remember that IBD does a lot of the work for you. You'll find highlights of stocks forming cup-with-handles and other patterns as you review *IBD 50*, *Your Weekly Review*, *Stock Spotlight* and other features as part of your daily and weekend routines (Chapter 4).



Chipotle Mexican Grill increased 186% from September 2010–April 2012.



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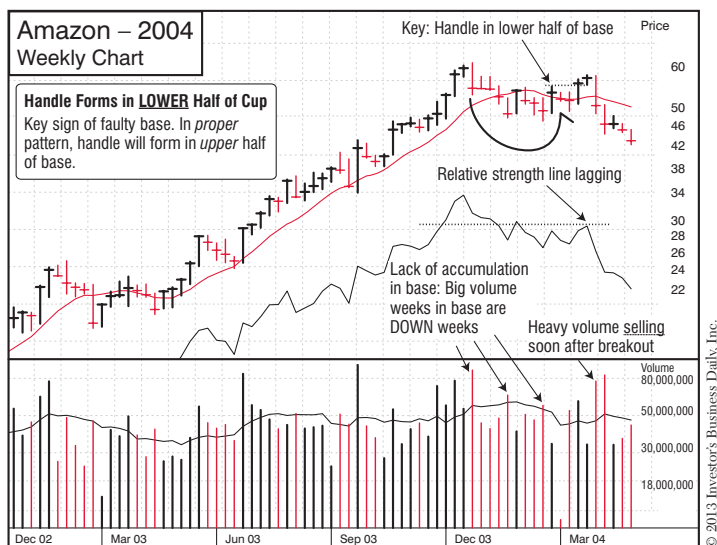
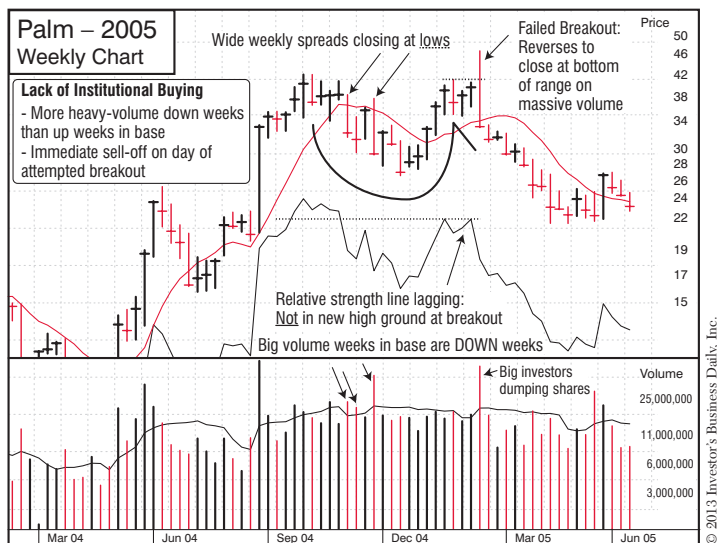
Apple increased 596% from March 2004–January 2006.

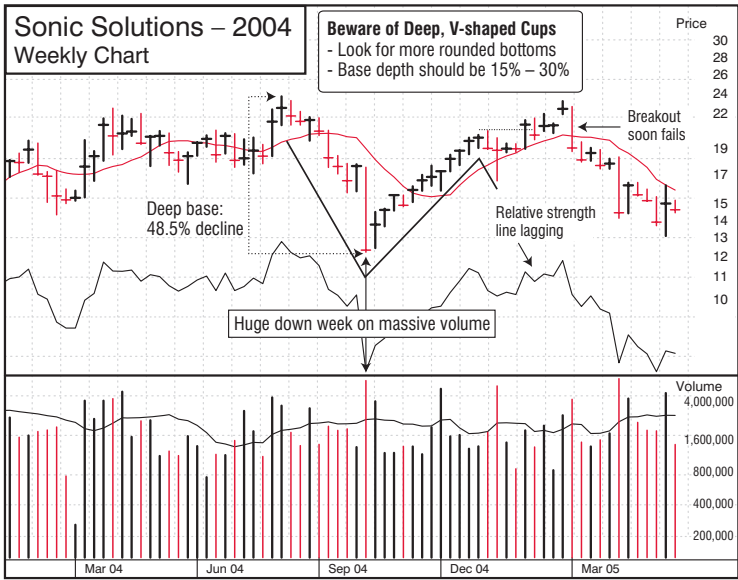
Faulty Cup-with-Handles

Sometimes the best way to see what works is to study what *fails*.

Take a look at the following chart patterns, and see how they stack up against the traits of proper—and successful—cup-with-handle formations.

Learning to spot these kinds of flaws will help significantly improve your stock-picking batting average.





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Finding Flaws

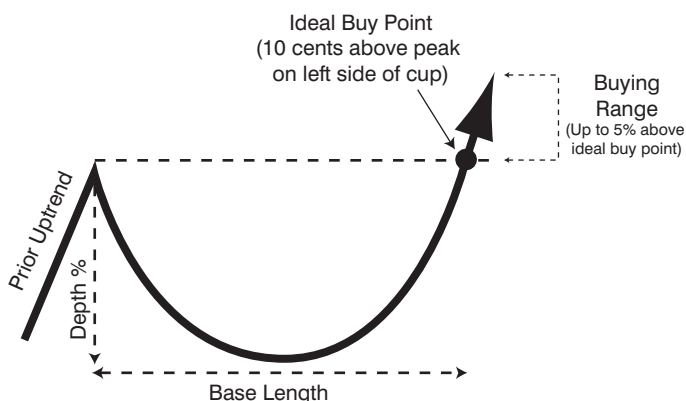


In the *IBD 50* and *Your Weekly Review*, you'll find alerts to warning signs and potential flaws in a base. That'll also help you learn to spot them on your own.



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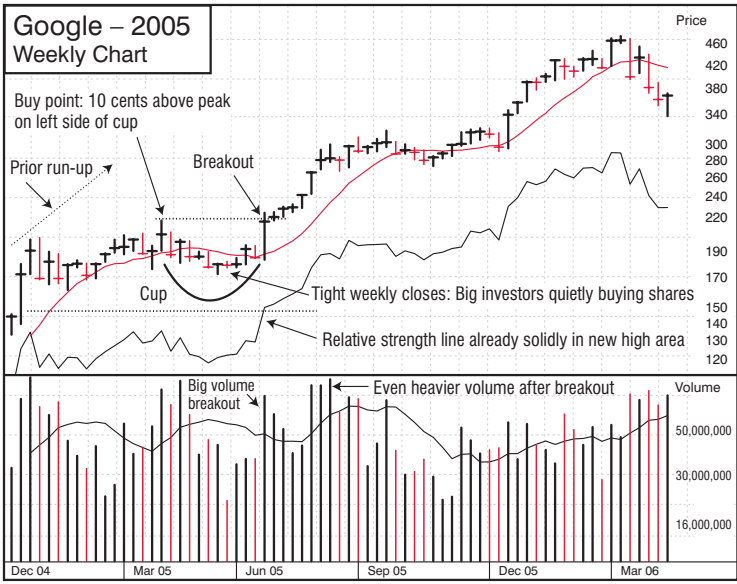
Cup-without-Handle



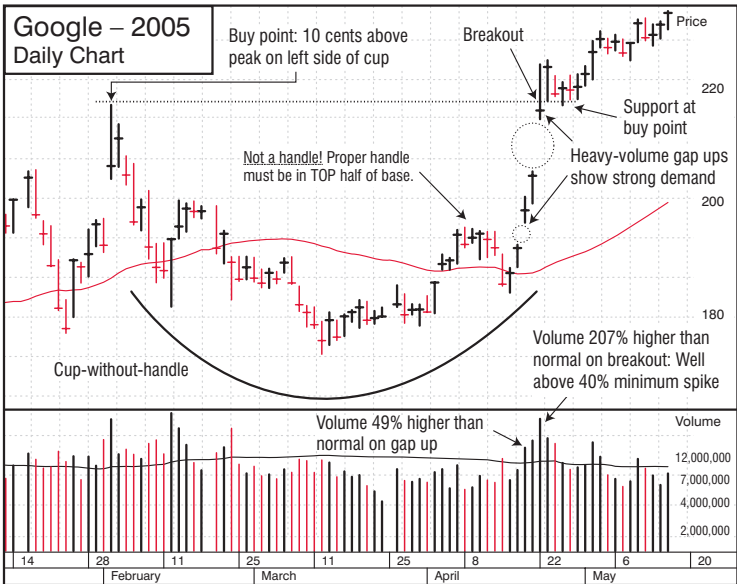
The cup-without-handle—also called a cup-shaped base or simply a cup—is a variation on the cup-with-handle pattern. As the name implies, it's essentially the same, except it doesn't have a handle. All the attributes, except for the buy point, are identical.

The buy point in a cup-shaped base is calculated by adding 10 cents to the peak on the left side of the cup—the most recent area of resistance.

Next is an example of how Google formed a cup-shaped base that launched a 119% gain in less than 10 months.



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Google increased 119% from April 2005–January 2006.

See How to Spot a Cup-with-Handle

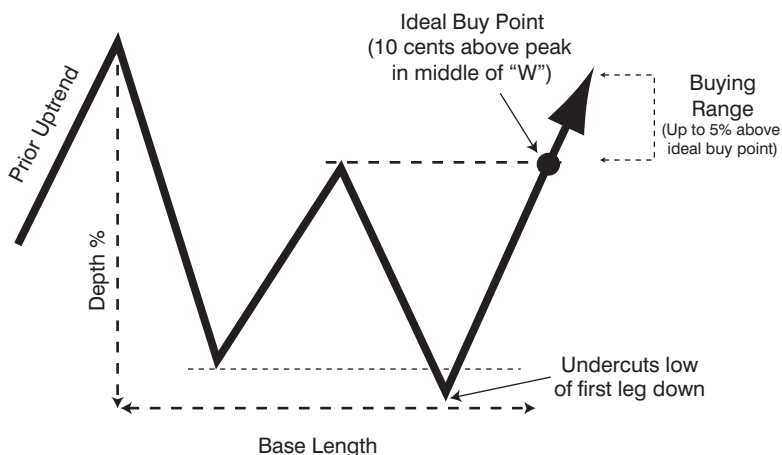


Watch a short video at www.investors.com/GettingStartedBook.

Double Bottom

Second Most Common Pattern

- Looks like a lopsided “W”
- Often occurs when overall market is choppy and volatile
- Can also set the stage for huge price gains



What to Look For

While the shape is different than a cup-with-handle, the core concepts and backstory of double bottoms are the same.

- **Mirroring the Market:** Double bottoms tend to form while the overall market is volatile, and that’s reflected in the shape. You have one down leg, then the stock tries to rally but hits resistance and ends up pulling back to form a second down leg. The stock rebounds one more time and is finally able to punch through and move higher. The breakout typically occurs when the overall market has also bounced back from a correction into a new uptrend.
- **Support and Resistance:** Like the cup-with-handle and all other bases, the buy point for a double bottom is calculated by adding 10 cents to the most recent area of resistance. That’s the peak in the middle of the “W.”

Breaking through that resistance on unusually heavy volume shows institutional investors are back in the game, aggressively scooping up shares.

- **Shakeout:** Remember how the handle in the cup-with-handle shook out the weaker holders? You have the same concept here, just in a different place. Note how the bottom of the second leg in a double bottom undercuts the bottom of the first leg. That gets rid of the weaker holders, leaving more committed investors who create support for the stock's new run.

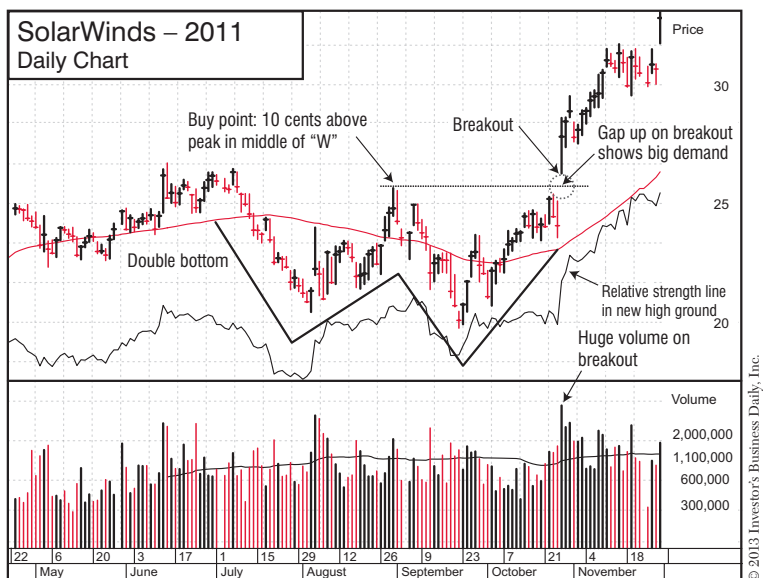
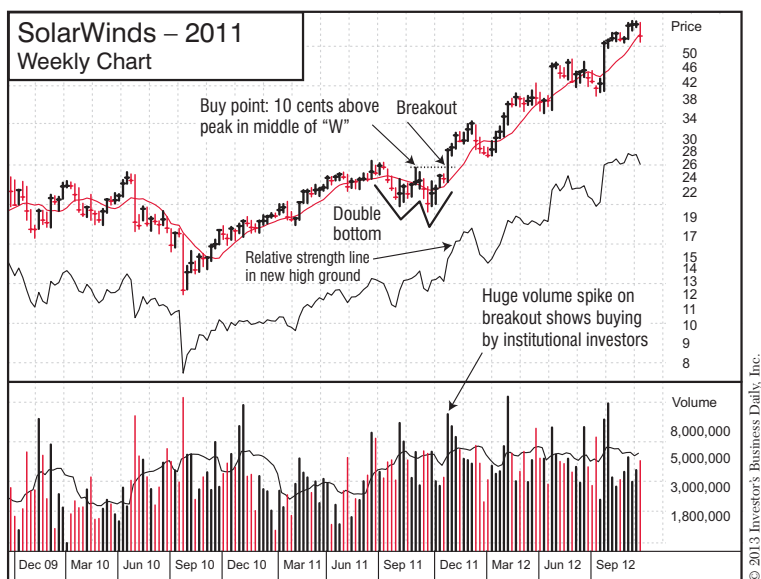
Here's a quick list of the key traits to look for in a double bottom.

- ☑ *Prior uptrend: 30% or more*
- ☑ *Base depth: 40% or less*
- ☑ *Base length: At least 7 weeks*
 - The first down week in the base counts as Week #1
- ☑ *Peak in middle of "W"*
 - Should form in upper half of base
 - Should be *below* left-side peak
- ☑ *Undercut: Bottom of second leg down should be lower than bottom of first leg down*
- ☑ *Ideal buy point*
 - 10 cents above the peak in the middle of the "W"
 - Buying range: Up to 5% above the ideal buy point
 - *Always buy as close as possible to the ideal buy point!*
- ☑ *Volume on day of breakout: At least 40%–50% above average*

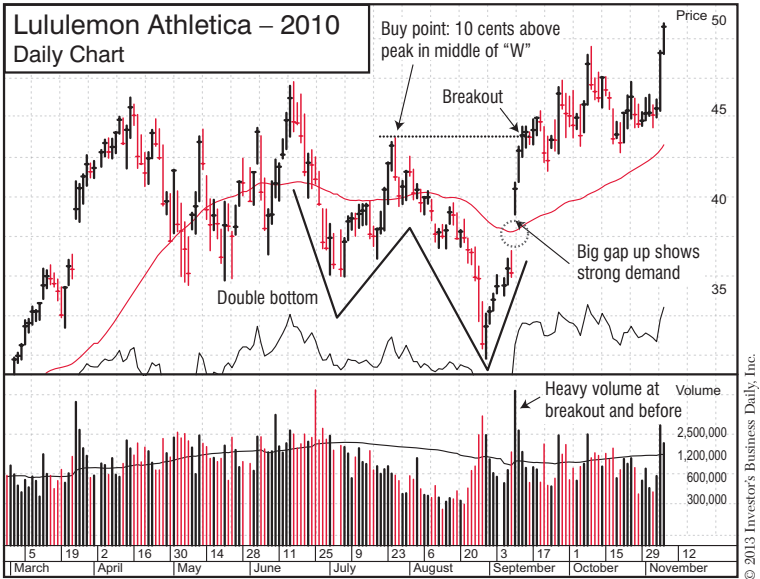
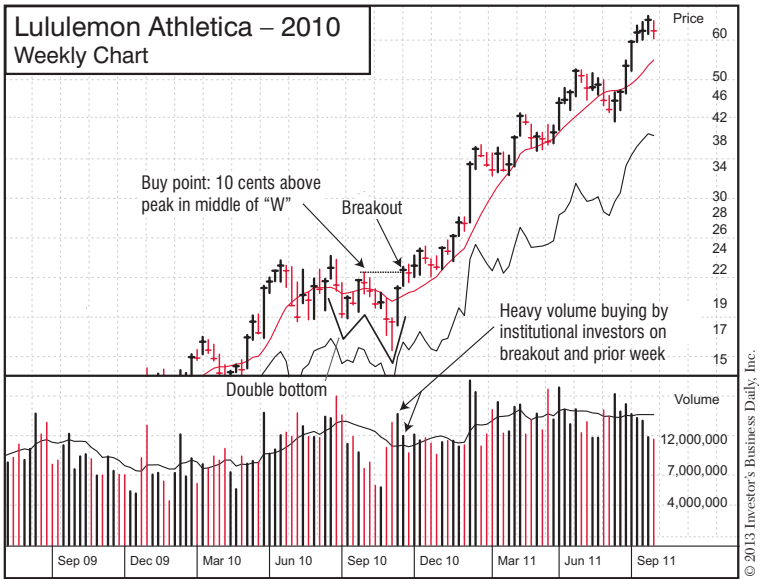
Launching Big Gains with the Double Bottom

Below are examples of winning stocks that launched big runs from a double bottom.

Again, don't rush through these examples. Study what the patterns look like on both the daily and weekly charts, and look for big spikes in volume on the breakouts.



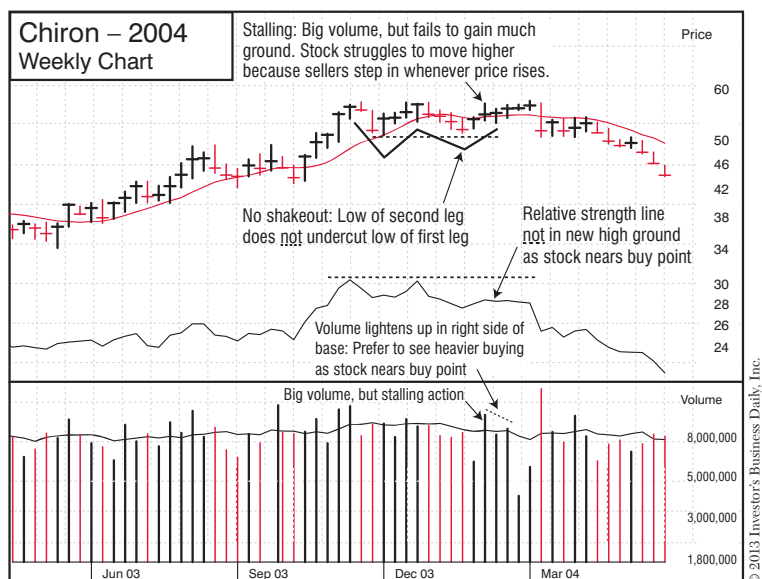
SolarWinds increased 137% from October 2011–September 2012.



Lululemon Athletica increased 196% from September 2010–July 2011.

Faulty Double Bottoms

Here are some common flaws to look out for when reviewing a potential double bottom pattern.



In a double bottom, make sure the low in the second leg down undercuts the low in the first leg.

See How to Spot a Double Bottom

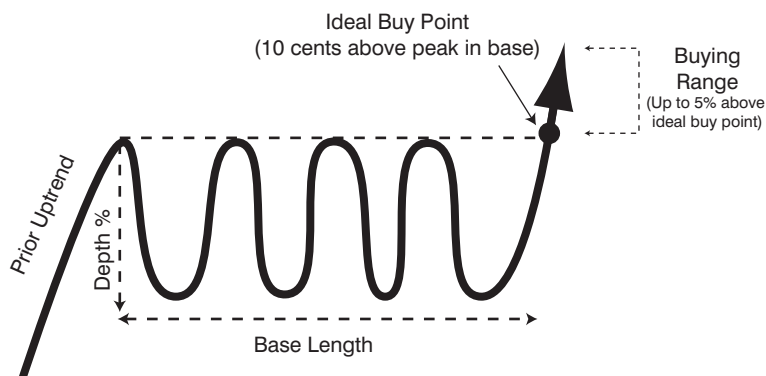


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Flat Base

Usually a Second-Stage Base

- Often occurs *after* a stock forms a cup-with-handle or double bottom
- Can offer another opportunity to start a new position or add shares to an existing one
- Milder decline than cup-with-handle and double bottom
- Shorter time frame (minimum 5 weeks)



What to Look For

Remember how we mentioned the best stocks will form “stepping stones” as they make their big moves? They’ll go up for a while, pull back to form a new base, then resume their climb—giving you *multiple* opportunities to make money.

The flat base is a classic example of that. They typically form *after* a stock has made a nice gain from a cup-with-handle or double bottom breakout. That’s why they’re often considered “second-stage” bases. (We’ll get into that later in this chapter in “Go Beyond Just the Shapes.”)

Here are the key concepts to understand.

- **Trading Sideways to “Digest” Earlier Gains:** Stock will often break out of a cup-with-handle or double bottom pattern, run up at least 20%, then go sideways to form a flat base. It’s a milder decline than what you see in other patterns—no more than 15%.

The price range will usually remain fairly tight throughout the base. That may mean institutional investors—who have to buy tens of thousands or more shares to establish their large positions—are quietly buying within a certain price range. That's how they increase their holdings without significantly driving up their average cost-per-share.

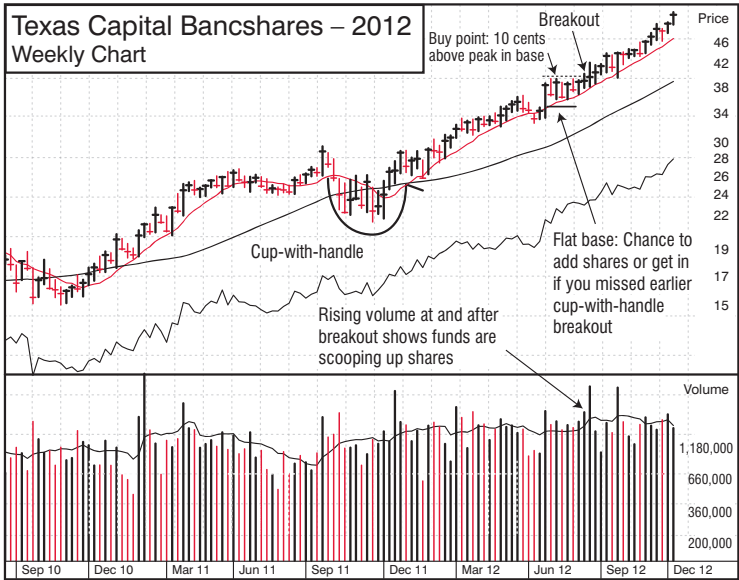
- **Support and Resistance:** Here again the buy point is determined by adding 10 cents to the most recent area of resistance—the highest price point within the flat base. Until the stock breaks through that “ceiling” (preferably on heavy volume), it won't be able to launch the next leg of its climb.
- **Shakeout:** Flat bases also have a way of shedding those weaker holders we keep mentioning. Instead of a sharper sell-off like the handle in a cup-with-handle or the second-leg undercut in a double bottom, the flat base shakeout is more of a slow grind. The weaker holders just get worn out by the indecisive, sideways action and eventually lose patience and sell.

Here's a quick list of the key traits to look for in a flat base.

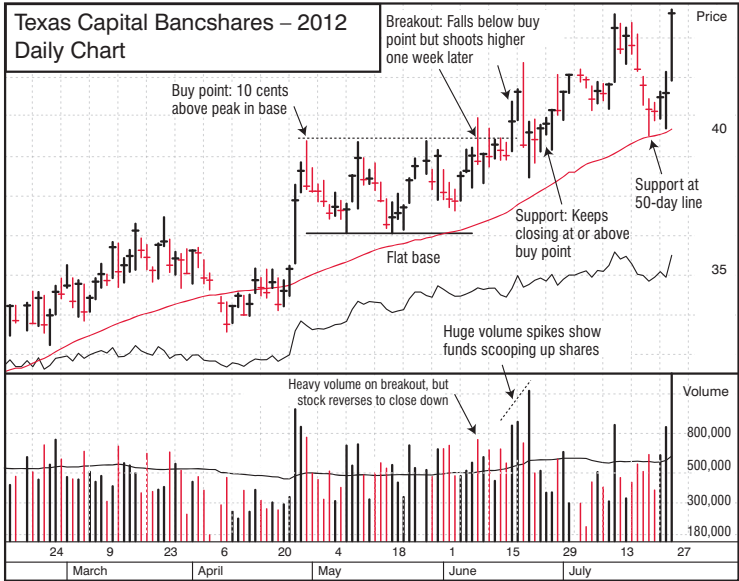
- ☑ *Prior uptrend: 30% or more*
- ☑ *Base depth: 15% or less*
- ☑ *Base length: At least 5 weeks*
 - The first down week in the base counts as Week #1
- ☑ *Ideal buy point*
 - 10 cents above the peak within the base
 - Buying range: Up to 5% above the ideal buy point
 - *Always buy as close as possible to the ideal buy point!*
- ☑ *Volume on day of breakout: At least 40%–50% above average*

Launching Big Gains with the Flat Base

Here are just two examples of winning stocks that launched big runs from a flat base.

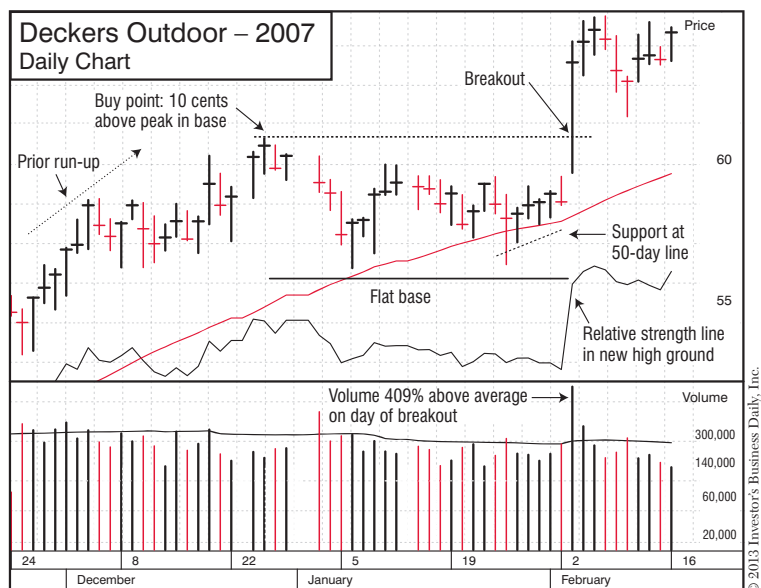
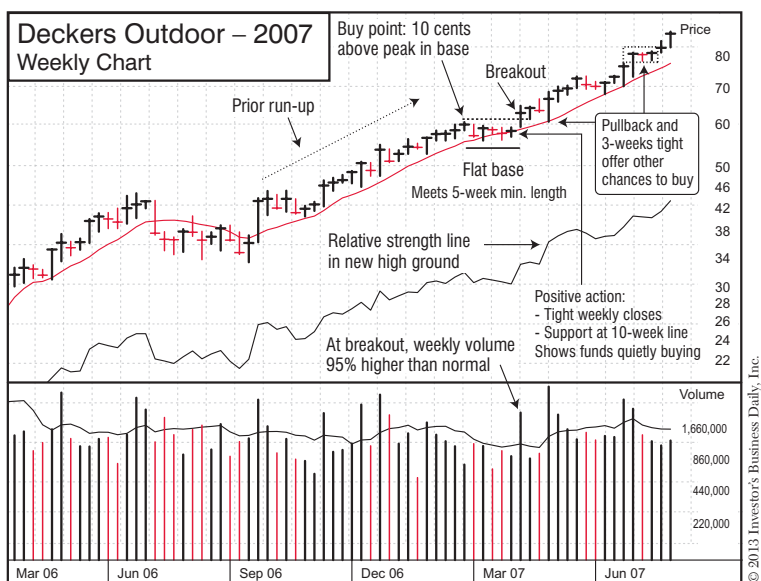


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Texas Capital Bancshares increased 33% from June–October 2012.

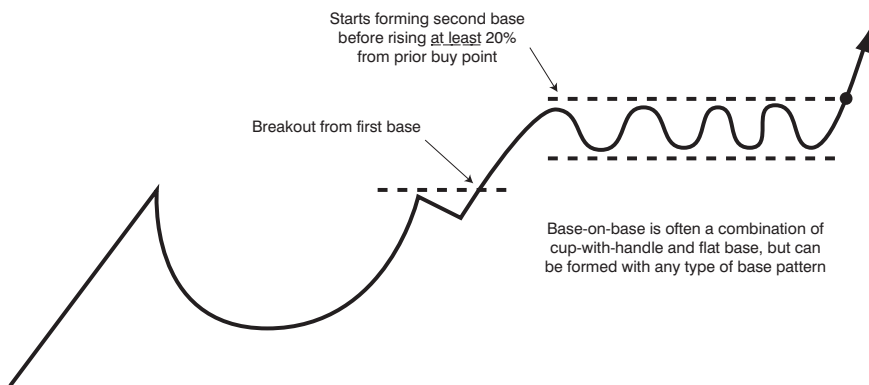


Deckers Outdoor increased 175% from February–December 2007.

More Second Chances with the “Base-on-Base”

Sometimes a stock will break out from a cup-with-handle or double bottom but fail to make the typical 20%–25% gain before starting to form a *new* pattern.

When that happens, we call it a “base-on-base” formation—and it can lead to some powerful moves.



Here are the 2 key things to understand about a base-on-base:

- **The stock must begin forming a new base *before* rising at least 20% from the ideal buy point in the prior pattern.**

Here's how that works.

Say a stock breaks out of a cup-with-handle with an ideal buy point of \$100. If it starts forming a flat base after climbing to just \$115—only a 15% rise—the prior cup-with-handle *and* the new flat base would be considered one “base-on-base” formation.

- **The ideal buy point depends on what type of pattern the *second* base is.**

While the *second* base in the base-on-base can be any type of pattern, it often ends up being a flat base. Whatever type of formation it is, all the normal criteria for that pattern still apply.

So if it's a flat base, the ideal buy point would be 10 cents above the peak in that flat base.

If the second pattern in the base-on-base is a cup-with-handle, then the buy point would be 10 cents above the peak in the handle.

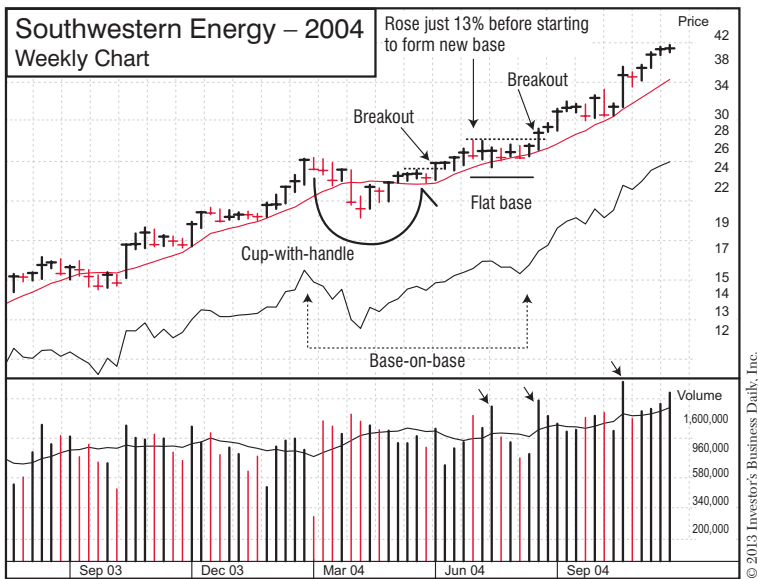
Mirroring the Market Once Again

Just as double bottoms typically form when the overall market is volatile, base-on-base patterns often appear when there is uncertainty or significant selling pressure.

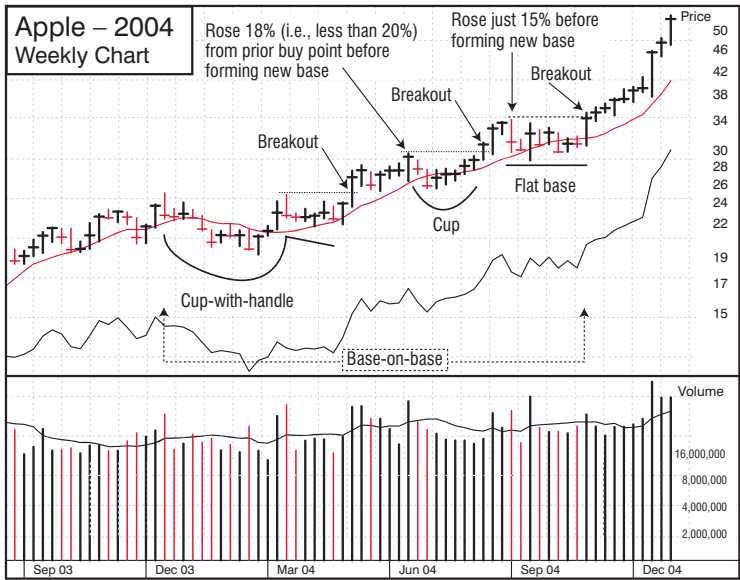
You'll see stocks make that initial breakout from the prior pattern, but then the overall market weakens and they quickly pull back to form that second base.

The good news is, once the heavy "weight" of a market downturn or selling pressure is removed, leading stocks break out from these base-on-base and other patterns and quickly spring higher to new gains.

Here are examples of the kind of profits base-on-base patterns can deliver.



Southwestern Energy increased 504% from June 2004–October 2005.



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Apple increased 402% from August 2004 to January 2006.

See How to Spot a Flat Base



Watch a short video at www.investors.com/GettingStartedBook.

Go Beyond Just the Shapes

Once you spot the *shape* of a chart pattern, also look for signs of “accumulation” (institutional buying) and support within the base. That’s how you separate sound patterns from potentially faulty ones.

This comes back to Big Rock #3 we discussed earlier: Buy stocks being heavily bought by institutional investors. Avoid those they're heavily selling.

Look for “Clues” in the *Daily Stock Analysis* Videos

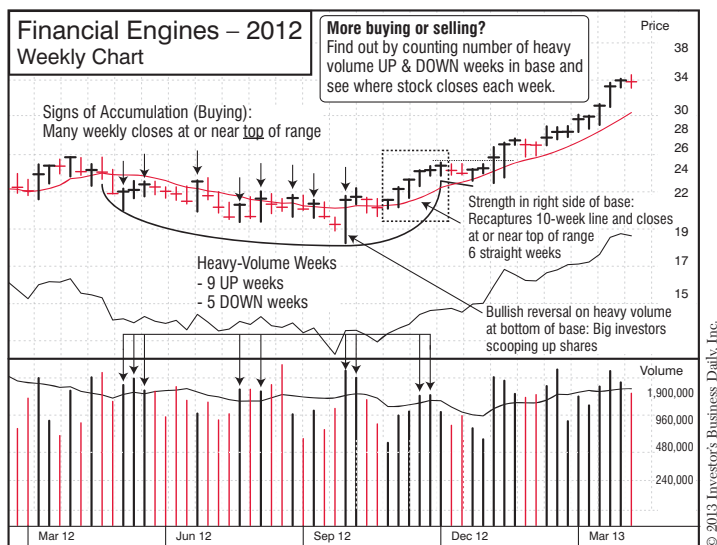


Regularly watching these free videos in the *IBD TV* section of Investors.com is an easy way to improve your chart-reading skills. See how at www.investors.com/GettingStartedBook.

Signs of Institutional Buying

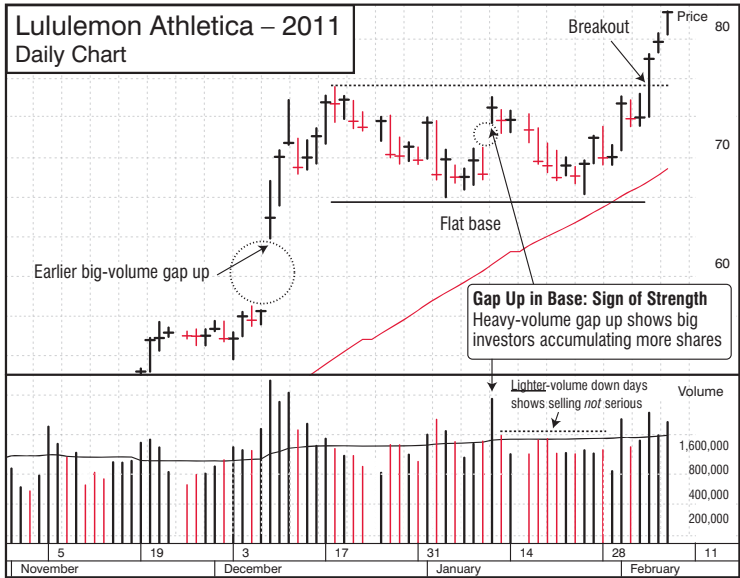
These signals further confirm that big institutional investors are enthusiastic about the stock and are buying up shares, providing the fuel for a higher climb.

- More up weeks on heavy volume than down weeks on heavy volume in the base



Financial Engines increased 48% from November 2012–March 2013.

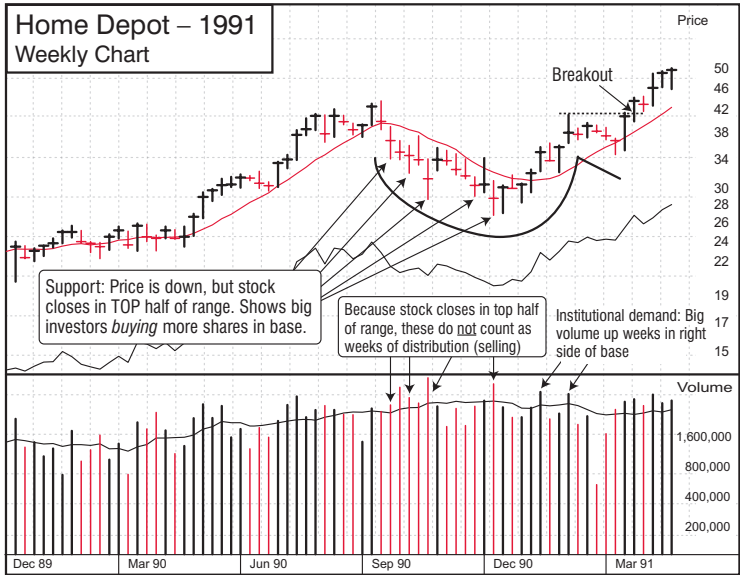
- Gap ups on heavy volume



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Lululemon Athletica increased 72% from February–July 2011.

- Positive reversals, and closes in the upper half of the range



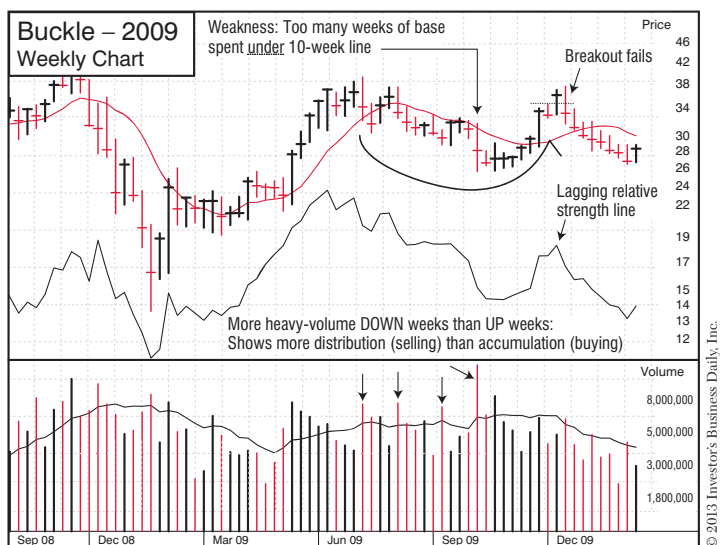
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Home Depot increased 275% from January 1991–January 1993.

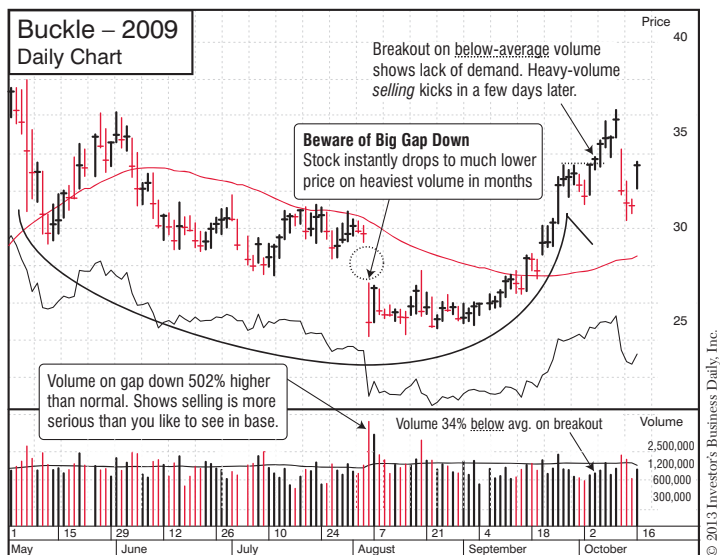
Warning Signs

When you see these signs of institutional selling or uncertainty in a cup-with-handle or other pattern, proceed with caution. That base is less likely to launch a big move and is more likely to fail.

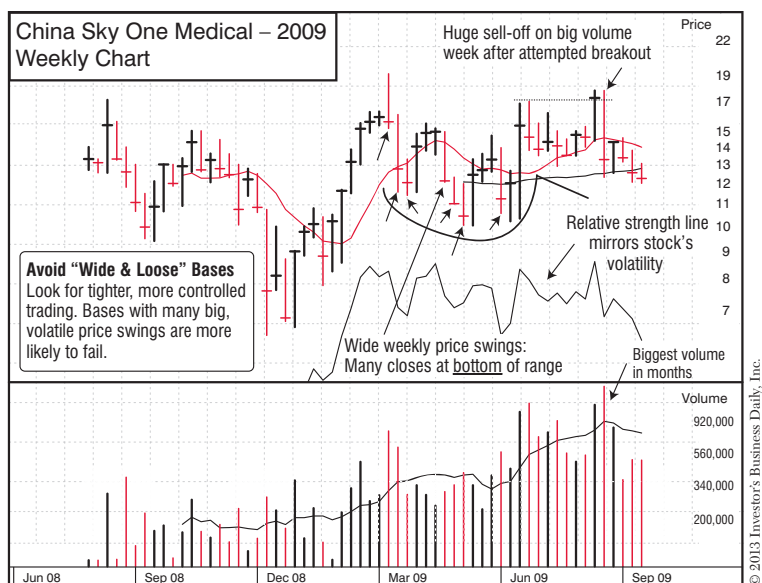
- Too many down weeks on heavy volume



- Gap downs on heavy volume



- Wide and loose, volatile trading action



Compare China Sky's wide and loose action to the tighter, healthier trading in the chart for Financial Engines we saw earlier in "Signs of Institutional Buying."

Beware of Late-Stage Bases

Nothing goes up forever.

As we saw earlier, the big money is made in the *early stages*—usually the first 1–2 years—of a new bull market. That's when the prior *bear* market has wiped the slate clean, and a new crop of leading stocks break out from a chart pattern and soar higher.

As they continue to climb higher, these stocks will likely take a breather and form another chart pattern along the way—maybe a flat base. That would be a second-stage base.

The Reset Button



Generally, a bear market resets the "base count"—the number of chart patterns the stock has formed since the start of its big run. So the first breakout in a new bull market is considered a first-stage base. Note: Milder "interim corrections" do *not* reset the count (Big Rock #1, Chapter 3).

By the time a stock starts forming a third- or fourth-stage base, it could be getting a little long in the tooth. Here's why:

- **The stock itself has already made a big move.** It could be up 100% or more. How much higher can it really go before institutional investors cash in their profits and put the stock into a deep decline?
- **The overall market may be running out of steam.** When you get into the third year of a bull cycle, the market tends to get more volatile and choppy. That impacts the leading stocks, and they may also struggle to move higher.

That's the basic reason you want to be careful about buying stocks as they break out of a third- or even later-stage base.

Late-stage patterns *can* work and sometimes do lead to nice gains. But successful investing is about keeping the odds in your favor. So just understand that late-stage bases involve more risk. If you buy a stock on a late-stage breakout, you might cut your losses sooner—say, at 3%–4%—if the stock fails to gain traction.

See How to “Count” Bases

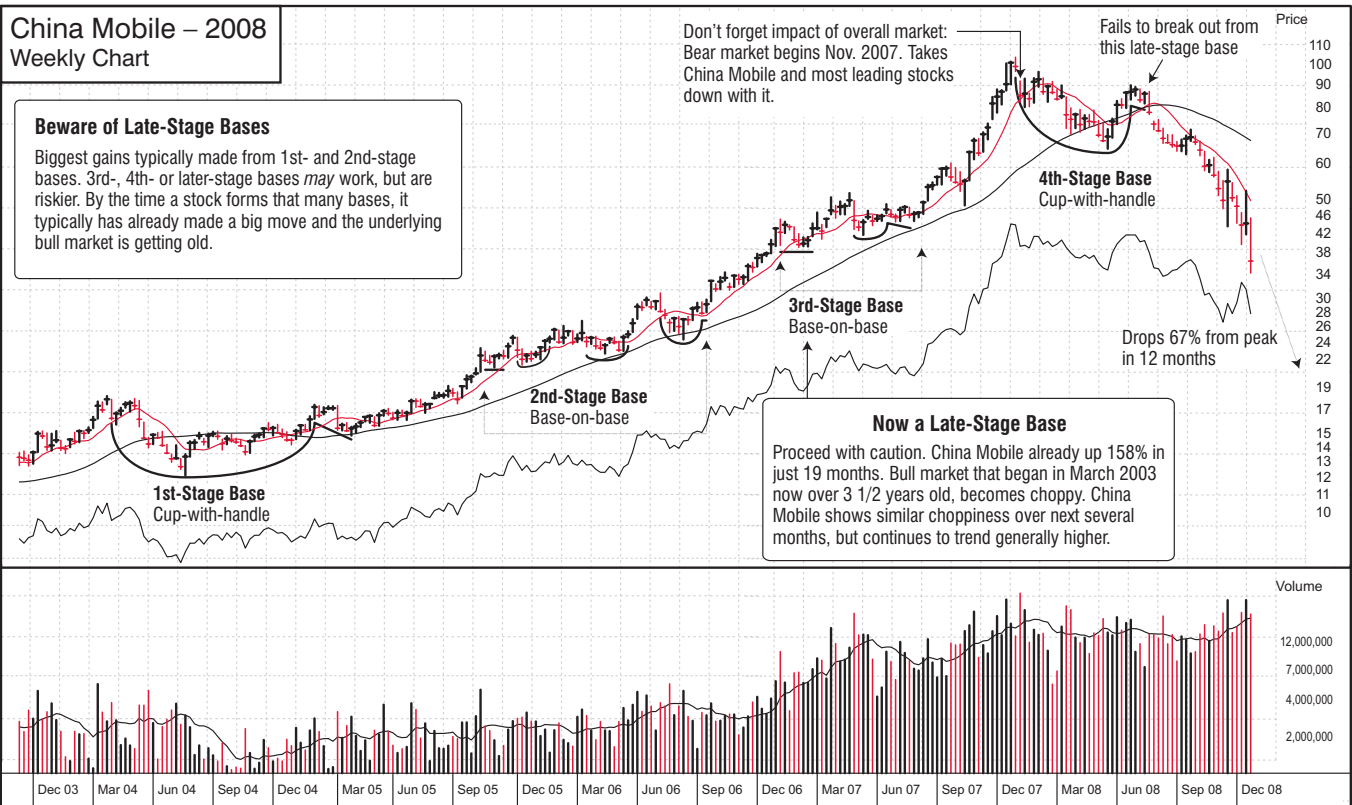


This is easier to “show” than “tell,” so if you’d like to learn more about late-stage bases, check out a short video on that topic at www.investors.com/GettingStartedBook.

China Mobile – 2008 Weekly Chart

Beware of Late-Stage Bases

Biggest gains typically made from 1st- and 2nd-stage bases. 3rd-, 4th- or later-stage bases *may* work, but are riskier. By the time a stock forms that many bases, it typically has already made a big move and the underlying bull market is getting old.



Later-stage bases *can* lead to good gains, but they are riskier than first- and second-stage patterns.

See a Pattern Here?

Now it's time to put what you've learned to the test!

Here's how to do it:

1. Go through the examples below and see if you can spot a pattern within each chart. If you do, can you name the type of base and see the ideal buy point?
2. Once you spot the pattern, look for the “clues” we discussed in “Go Beyond Just the Shapes.” Do you see any? What do they tell you about the stock and chart pattern? Is the relative strength line in or near new high territory?
3. See how you did by checking the markups I've included for the same chart on a different page.

The More You Practice, The More You Profit



Don't expect to learn all of this in one sitting! Take chart-reading one step at a time, and you'll see it all come together very soon.

Here's what I suggest: **Before and/or after you take this quiz, watch the videos I included at the end of each chart pattern description and do the Simple Weekend Routine.** That will help you improve your own chart-reading skills—and see where to find stocks forming these 3 telltale patterns *right now*.

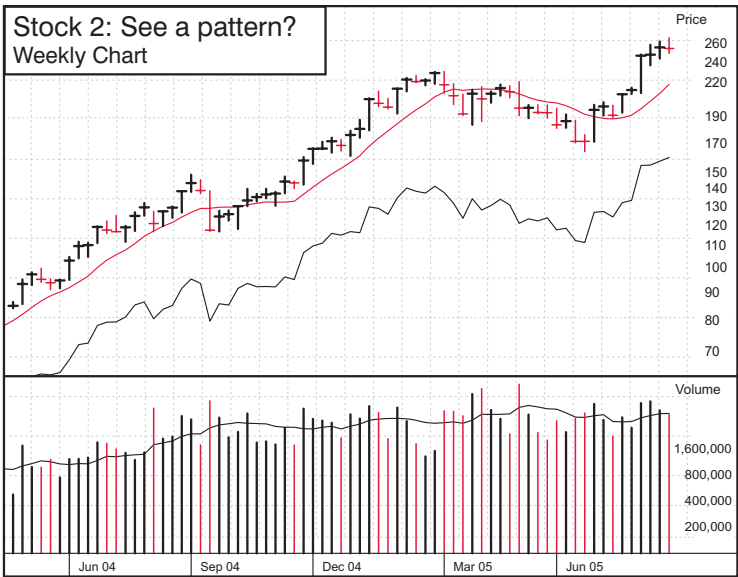
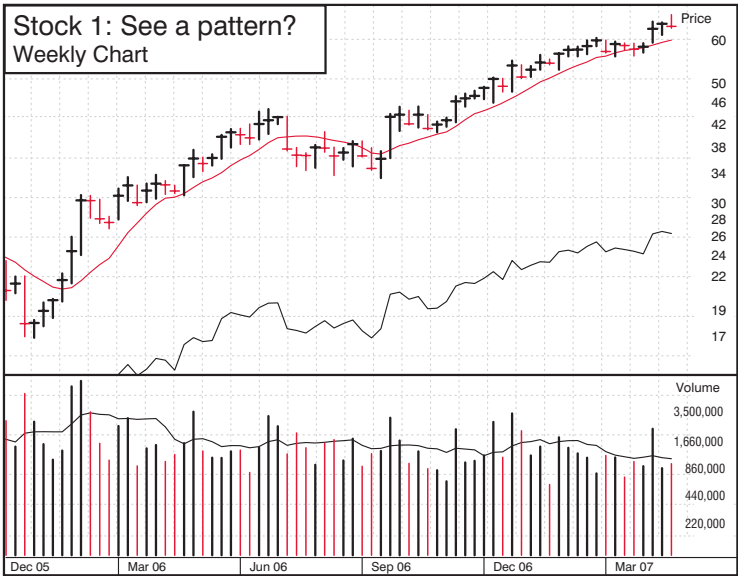
Don't Forget to Take Advantage of Free Investor Training

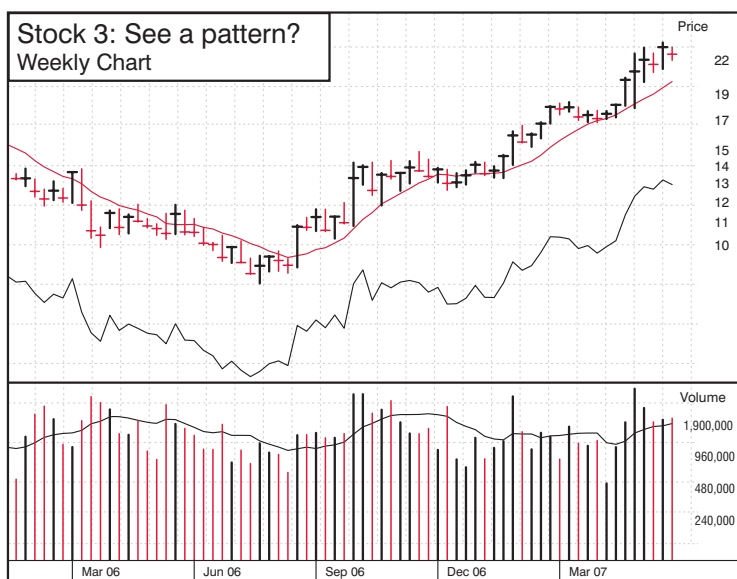
Have you done the “Must-Do” steps I mentioned in the Introduction?

- Check out the local **IBD Meetup** group near you.
- Sign up for online **IBD Product Training**.

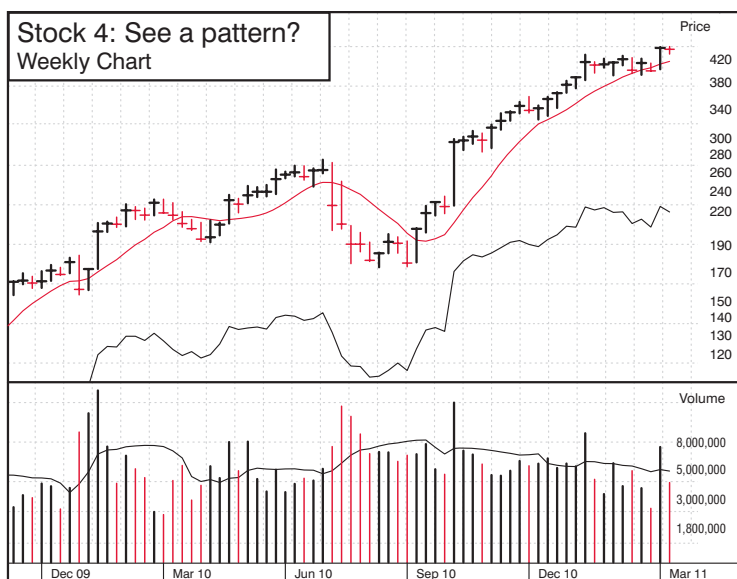
Both are free—and both will help you improve your chart-reading skills and get answers to any questions you may have. You can take both steps right now at www.investors.com/GettingStartedBook.

Can You Spot the Patterns?

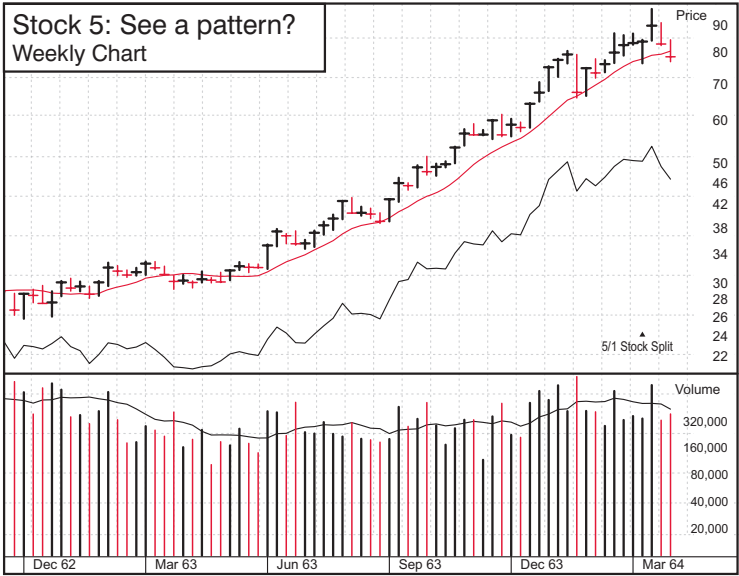




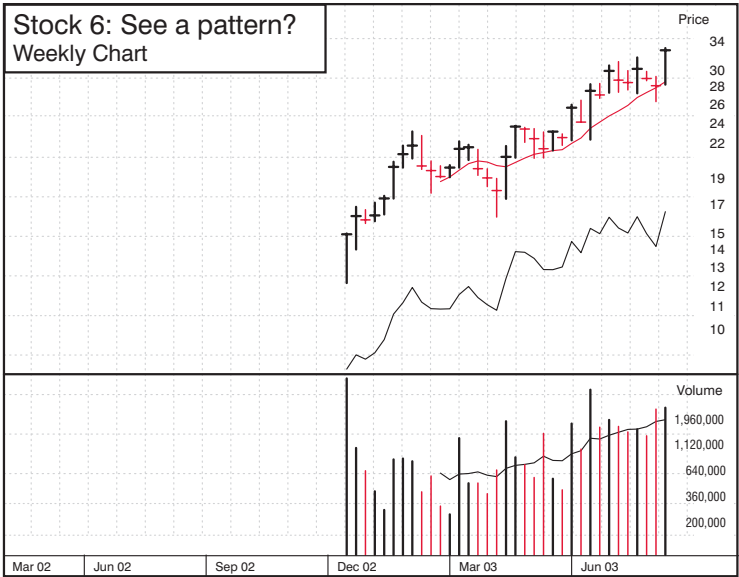
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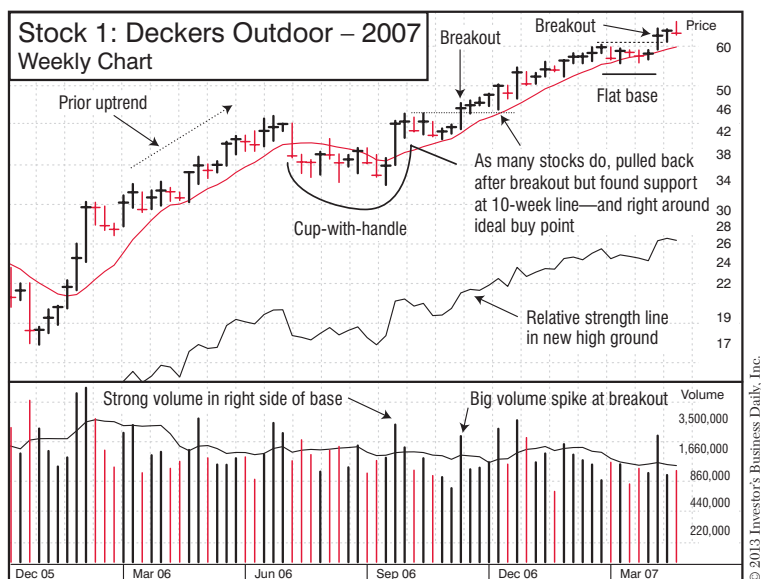


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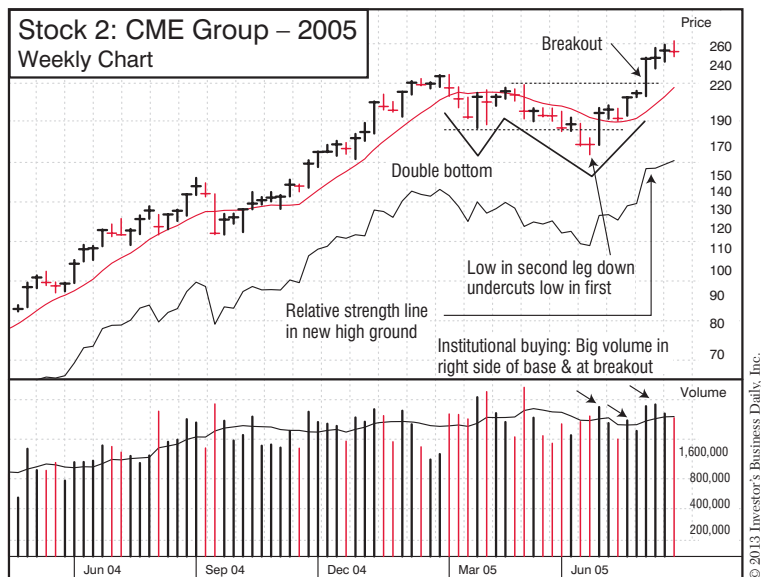


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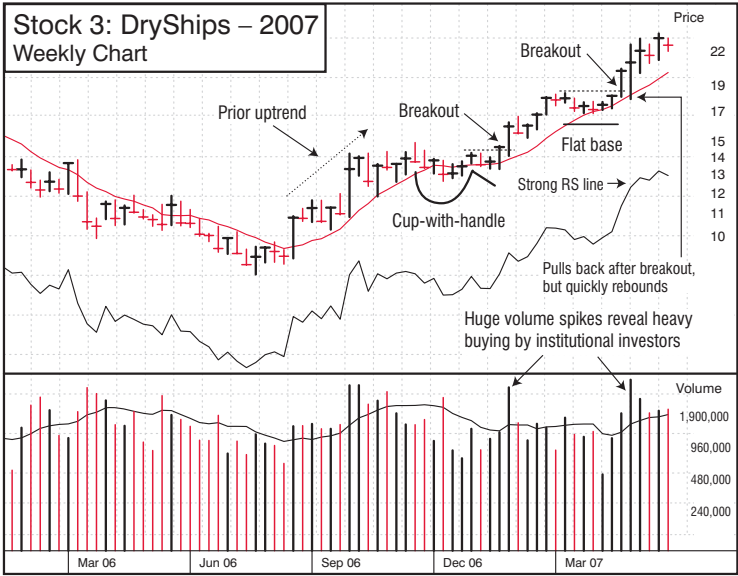
See How You Did by Checking These Markups



Deckers Outdoor increased 151% from September 2006–August 2007.

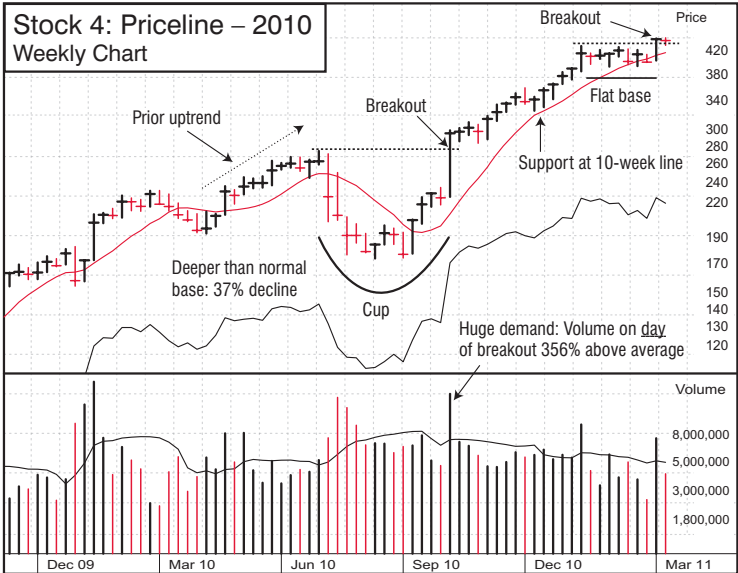


CME Group increased 224% from June 2005–December 2007.



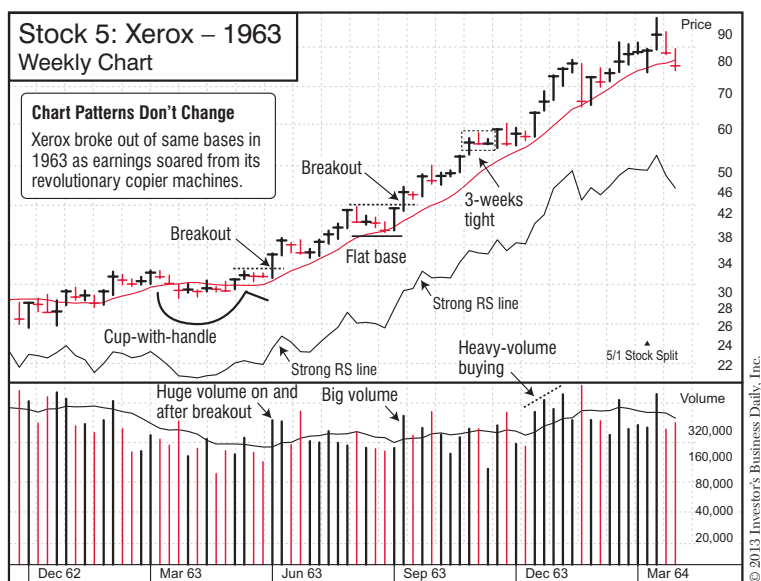
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DryShips increased 815% from January 2006–January 2007.

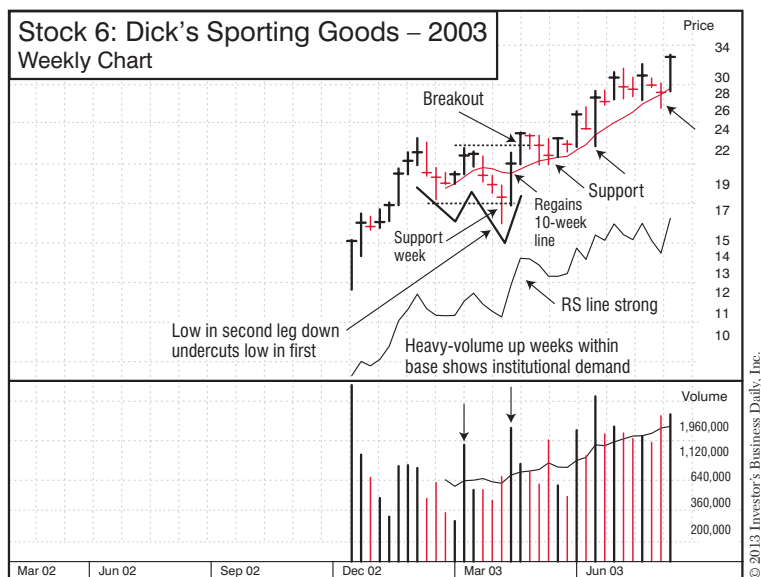


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Priceline.com increased 105% from August 2010–May 2011.



Xerox increased 660% from April 1963 to April 1966.



Dick's Sporting Goods increased 181% from February 2003–April 2004.

Stick with It!

Keep improving your chart-reading skills—while also building a timely watch list—by regularly watching the *Daily Stock Analysis* and *Market Wrap* videos at Investors.com/IBDtv.

Alternative Buy Points

The cup-with-handle, double bottom and flat base are the main patterns that launch big runs. But what if you miss those breakouts? Don't worry. All is not lost!

The big winners will typically form alternative buying opportunities. You can use these to initiate a position in the stock—or *add* to your position if you *did* catch the breakout.

Less Is More

Since these are secondary buy points, it's a good idea to buy a smaller position than you would from, say, a cup-with-handle. That's especially true if you're buying more shares in a stock you already own. In that case, you always want to buy fewer shares than you purchased in the initial breakout. That keeps you from running up your *average* purchase price too much.

Here are two of the most common alternative buying opportunities.

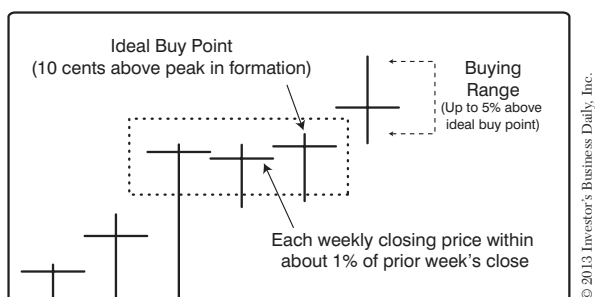
3-Weeks Tight

Like a flat base, this occurs after a stock breaks out, goes up for a while, then pauses to digest those gains.

As the name implies, it only takes 3 weeks to form. Here are the key points:

- ✓ *Each weekly close should be within about 1% of the prior week's close.*

That's what creates the “tight” range you see in the chart. Remember to focus on the weekly *closing prices*. During the week, the share price may move around a bit, but you're focused on where it *closes* on Friday.



What do the tight weekly closes tell you? That institutional investors are holding onto their shares.

Fund managers and other professionals expect more from the stock, so they're not taking their profits off the table. In fact, they're quietly accumulating *more* shares, and that's what keeps the stock in that tight and narrow price range.



Ideal buy point

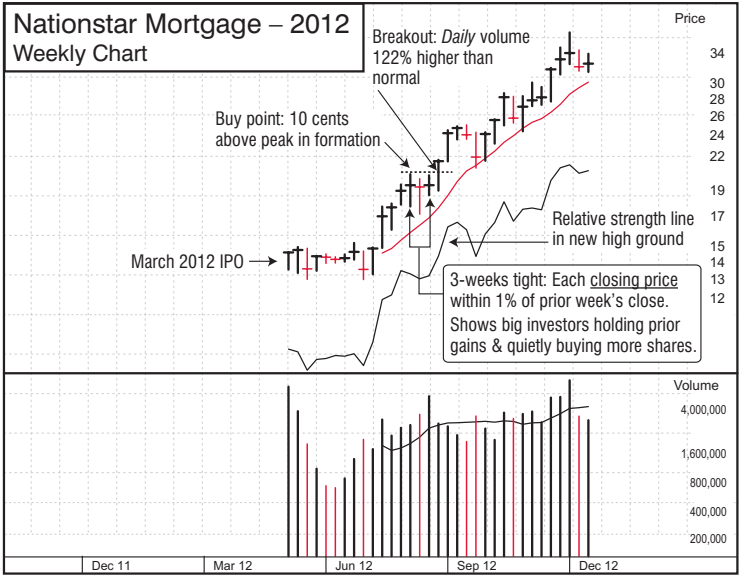
- 10 cents above the peak in the formation (i.e., the most recent area of resistance)
- Buying range: Up to 5% above the ideal buy point
- *Always buy as close as possible to the ideal buy point!*



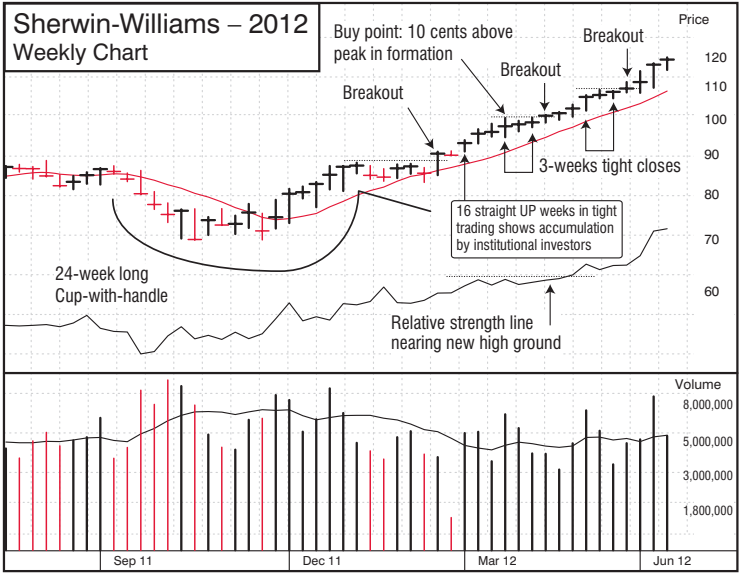
Volume on day of breakout: At least 40%–50% above average

As with all bases, you want volume to be at least 40%–50% higher than normal on the breakout to show that fund managers and other professional investors are jumping in.

Next are just 2 examples of how a 3-weeks tight can give you an opportunity to pick up shares as a winning stock continues its run.



Nationstar Mortgage increased 82% from June–October 2012.



Sherwin-Williams increased 57% from February–October 2012.

See How to Spot a 3-Weeks Tight Pattern



Watch a short video at www.investors.com/GettingStartedBook.

Pullback to 10-Week or 50-Day Moving Average Line

After a stock has broken out of a proper chart pattern, it may pull back to the benchmark 10-week or 50-day moving average lines we discussed earlier. *If the stock bounces off the moving average line and shoots higher on heavy volume, it can offer a chance to buy shares.*

That type of behavior shows institutional investors are stepping in to “support” and defend the stock. It happens around these moving average lines simply because professional investors use those lines as key benchmarks (see “Chart-Reading 101” in this chapter).

Don't “Buy on the Dips”

You'll often hear pundits talk about “buying on the dips”—that is, buying a stock just because its share price is now lower and appears to be a “bargain.” That's an *extremely* risky strategy. A stock going down in price is going down for a reason.

Depending on how heavy the volume is, one of those reasons may be that fund managers are dumping shares and moving out of the stock. Remember “Big Rock #3”: Buy stocks being heavily bought by institutional investors. Avoid those they're heavily selling.

So how is buying on a “pullback” different?

Simple: You wait for the stock to find support and move *up* on *heavy* volume before you buy. In other words, don't buy it if it keeps going *down*!

Here are some basic guidelines for how to properly buy on a pullback:



Look for light volume on the pullback

This shows professional investors are *not* aggressively selling shares. Volume may be above average certain days or weeks during the pullback, but overall it should be “drying up” or getting lighter as the stock nears the moving average line.

- ✓ *Make sure the stock bounces off the moving average line and heads higher on heavy volume*

You want the stock to rebound and show strength, not weakness, before you buy. Never buy a stock as it's moving *down*.

- ✓ *Buy as close to the moving average line as possible*

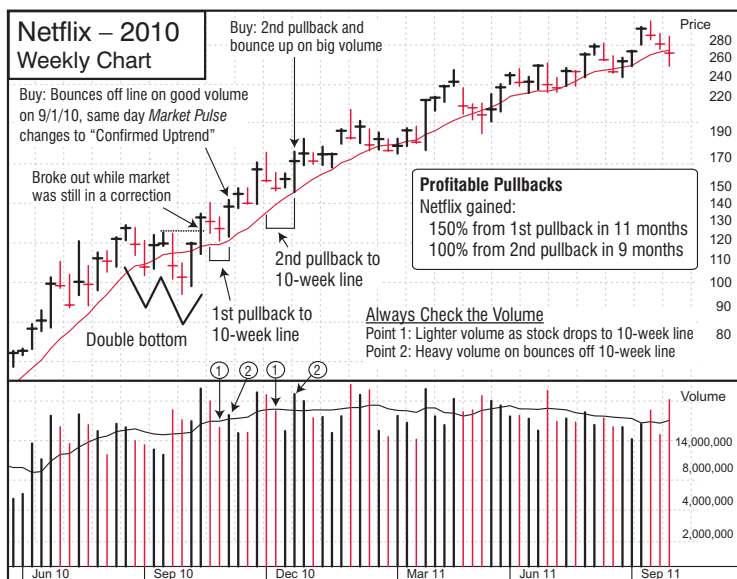
As the stock bounces off the 50-day or 10-week moving average line, you want to buy as close to that line as possible. The farther away from the line you buy, the riskier it gets.

- ✓ *Focus on the first 2 pullbacks*

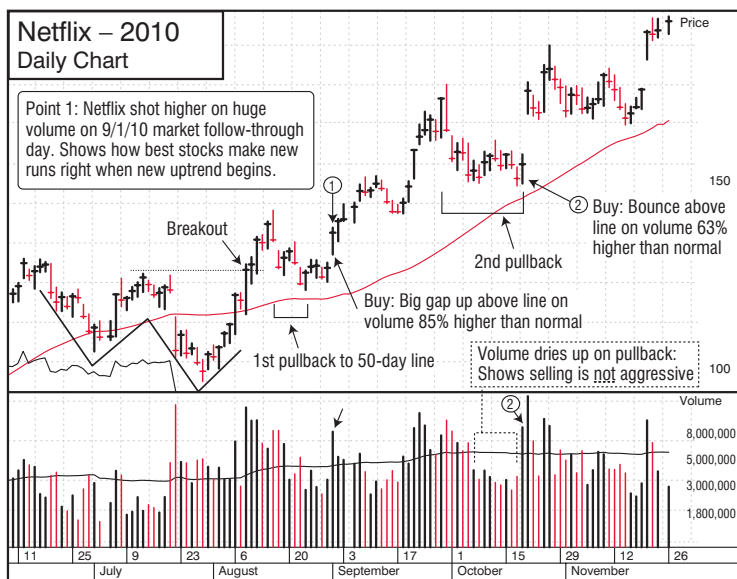
The best gains typically come from the first 2 pullbacks to the 10-week line. By the time a stock's third or fourth retreat occurs, it likely has already had a good move. Chances are now higher that the pullback is actually the start of a more serious sell-off.

Study the following weekly and daily charts for Netflix. They show how a pullback can be an opportunity to add shares to a winning position, or a second chance to buy into a stock if you missed an earlier breakout.

That's also a good reminder of why you want to continue to track winning stocks as they make a big move. They'll typically offer multiple opportunities for you to get in and profit.



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Netflix increased 150% from September 2010–July 2011.

5 Quick Guidelines for How to Buy on a Pullback



Watch my *2-Minute Tip* video on the right way to buy on a pullback at www.investors.com/GettingStartedBook.

Next up: Now that we’ve gone through Chart-Reading 101 and how to spot profitable chart patterns, let’s see how to check off the “Chart Analysis” items on the buying and selling checklists.

Using Charts to Go Through the Checklists

In the Buying Checklist and Selling Checklist sections we covered earlier, you saw how to quickly run through most of the buying and selling criteria using *Stock Checkup* and some basic rules.

Now that we've also covered the basics of chart-reading, let's see how to go through the “**Chart Analysis**” items on both checklists.

It Pays to Practice

If you're brand new to charts, I'm sure you're still trying to absorb all the patterns and concepts we just went through. As I keep saying—and as I know from personal experience—it takes a little time for it all to sink in and come together. But whatever you do, *don't give up on chart-reading!*

The practice you put in now *will* pay off down the road. So stick with it. Keep doing the Simple Weekend Routine, and keep watching the *Daily Stock Analysis* and other *IBD TV* videos. Spotting buy and sell signals in a chart will soon become second nature.

Let's start right now with a quick run through the Buying Checklist.

Buying Checklist

Chart Analysis: Buy stocks as they break out of the common patterns that launch big moves.

- ☐ Breaking out of sound base or alternative buy point
- ☐ Volume at least 40% to 50% above average on breakout
- ☐ Relative strength line in new high ground
- ☐ Within 5% of ideal buy point

As we go through this, don't forget *why* we put so much emphasis on following sound buy rules:

Stocks that pass the Buying Checklist have the greatest potential to make a *big* gain.

And by making each stock prove itself *before* you buy, you significantly increase your chances of starting out right—with a nice profit instead of a loss. That's why you want to always use this checklist as your starting point: Less risk, more reward.

 *Breaking out of a sound base or alternative buy point*

Is the stock nearing the ideal buy point in a cup-with-handle, double bottom or flat base—or an alternative buying area like a 3-weeks tight or pull-back to the 10-week line?

To help with your analysis, do a search on Investors.com to see what IBD has written about the stock's latest chart action. And if the stock is on the *IBD 50*, *Your Weekly Review*, *Sector Leaders* or *IBD Big Cap 20*, check the latest chart analysis. Does that analysis match what you're seeing?

If the stock is *not* forming any recognizable pattern or buy point, what does that tell you?

It means you need to stay patient. Stick to your rules and wait for a *proper* buying opportunity to emerge. A little discipline goes a *long* way to keeping you profitable and protected!

Is the Pattern Sound—or Suspect? Find Out with the Base Checklist



Download and print this little "cheat sheet" to help you quickly evaluate a cup-with-handle or other pattern. You'll find the Base Checklist at www.investors.com/GettingStartedBook.

 *Volume on day of breakout: At least 40%–50% above average*

If volume is *below* or just barely above average, that makes the breakout more suspect. Look for a big spike to show *enthusiastic* institutional buying.

Remember: 40%–50% is the *minimum* benchmark. On a strong breakout, you'll often see volume come in 100%, 200% or more above average.

How Can You Tell if Volume Is Unusually Heavy or Light?

- Check the “Volume % Change” feature.

IBD’s unique “Volume % Change” tells you *throughout the trading day* if volume is trending above or below average. You’ll see it when you pull up a stock quote on Investors.com.

So as a stock breaks out, you’ll find the *projected* Volume % Change based on the trading volume up to that point, letting you easily see if it’s on track to hit the 40%–50% benchmark.

Sector: INTERNET

Last Price: \$59.75 0.09 0.15%	Today's Range 59.40 - 60.48	52-Week Range 19.72 - 60.95
Volume: 1,562,200	EPS % Chg (Last Qtr) 50%	P-E Ratio 49
Volume % Chg: +45%	3 Year EPS Growth Rate 32%	Debt % 0
	EPS Est % Chg (Current Yr) 20%	Market Cap \$4.43 Bil
	Sales % Chg (Last Qtr) 40%	Dividend Yield NONE
	3-Year Sales Growth Rate 31%	Profit Margin 52.7%

09/21/2012 / Market Close

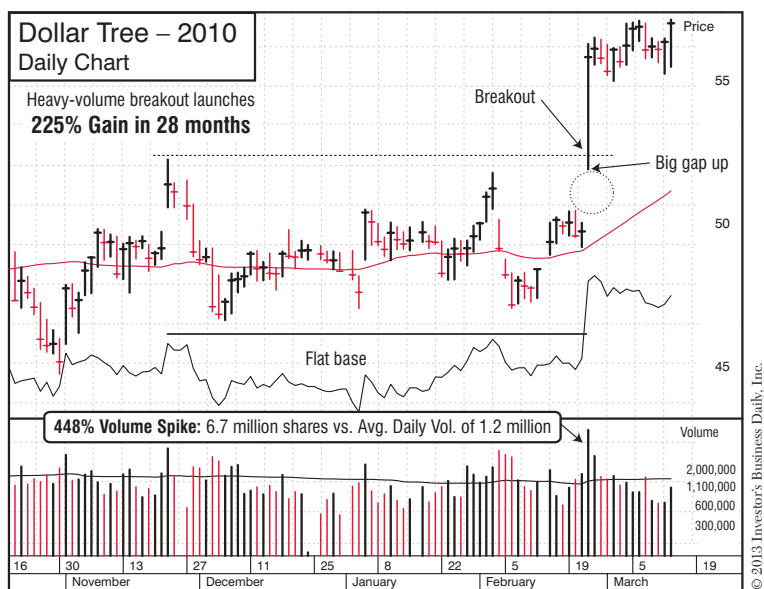
Volume % Change

Shows if volume is trending above or below average.

You'll find “Volume % Change” in *Stock Checkup* and the quotes pages on Investors.com and in *IBD Smart NYSE + Nasdaq Tables* (Chapter 7).

- **Check the *daily* chart.**

You can also see how heavy volume is on the day of the breakout with a quick glance at the daily chart.



Unusually heavy volume on a breakout shows strong institutional demand.

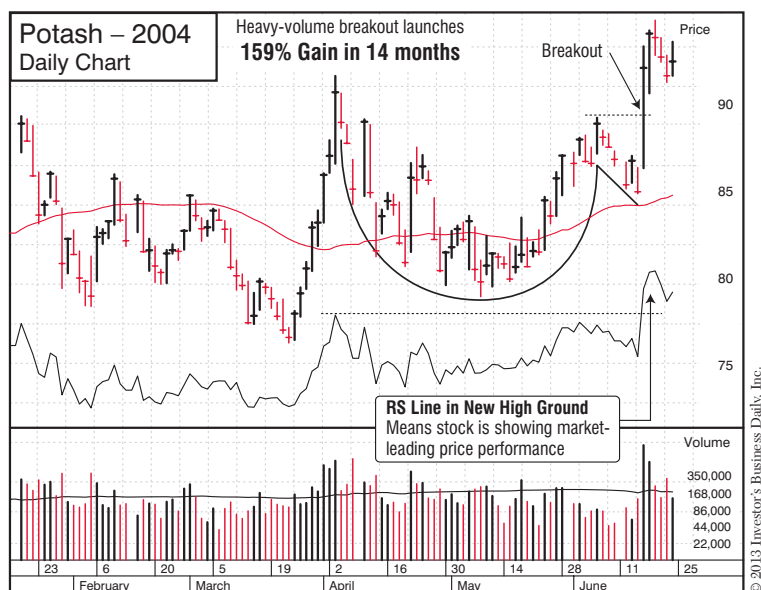
In some cases, you may find volume falls short of the 40%–50% benchmark on the day of the breakout, but heavy volume kicks in a day or two later. That's not ideal, but if the stock has the CAN SLIM® traits, is still within buying range (i.e., less than 5% above the ideal buy point) and volume comes in particularly strong, you could still buy it.

☒ *Relative strength line in new high ground*

The relative strength (RS) line compares the price performance of your stock over the last 52 weeks to that of the S&P 500.

- If the RS line is trending *higher*, the stock is outperforming the overall market.
- A *downward* trending line means the stock is lagging the market.

It's bullish to see the RS line already moving into new high territory as a stock completes its base and breaks out. It confirms the stock has bounced back from its correction and is now showing market-leading power.



Make a point to always check the relative strength line when evaluating a chart pattern.

✓ *Within 5% of ideal buy point*

As we saw earlier, the buy points and buying ranges of base patterns are all essentially calculated the same way:

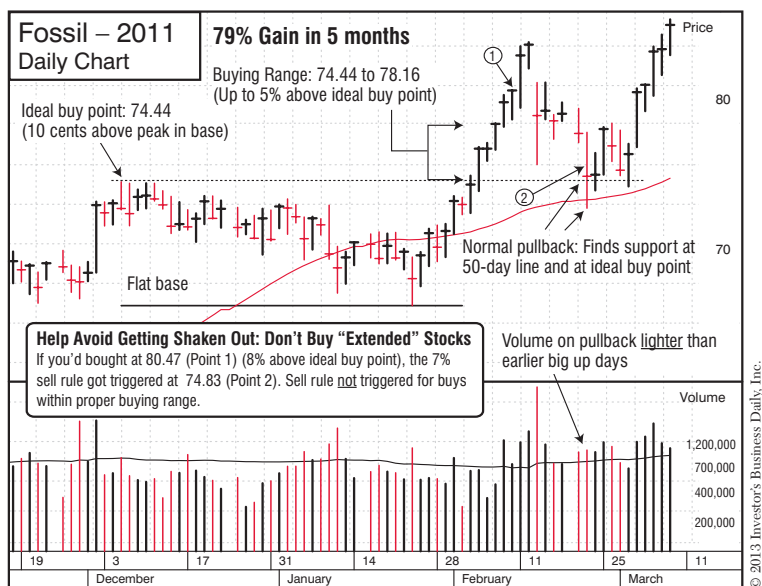
- **Ideal Buy Point:** 10 cents above the most recent area of resistance
- **Buying Range:** Up to 5% above the ideal buy point

Your goal is to buy as close to the ideal buy point as possible, but the stock can still be bought up to 5% past that price.

Don't chase "extended" stocks—those beyond the 5% buying range.

It just exposes you to unnecessary risk. Stocks often pull back after they break out, and the farther away from the ideal buy point you make a purchase, the higher chance you have of getting "shaken out" by the 7%–8% sell rule.

So if you miss a breakout, resist the temptation to chase that train down the tracks. Instead, wait for it to pull into the next station by forming a new base or alternative buy point like a pullback or 3-weeks tight. That allows you to board the train more safely and sensibly.



Stay disciplined and only buy stocks within a proper buying range.

Checking the Chart for Buy Signals



See a short video on how to run your stock through the "Chart Analysis" elements of the Buying Checklist at www.investors.com/GettingStartedBook.

Next up: Let's use charts and the Selling Checklist to look for early warning signs in a stock.

Using Charts to Go Through the Checklists

Selling Checklist

☐ **Chart Analysis:** Consider selling some or all of your shares if you see these signals:

- Biggest single-day price decline since start of stock's run on heaviest volume in months
 - Sharp drop below 50-day moving average line on heaviest volume in months
 - Sharp drop—and close—below 10-week moving average line on heavy volume
-

We've already covered the basic selling game plan:

- Take most profits at 20%–25%.
- Cut all losses at no more than 7%–8%.
- Take defensive action as a market downtrend begins.

That's a simple and effective way to nail down some good profits and avoid any serious losses.

And now that you've added charts to your investing toolbox, you can tap into *additional* ways to spot early warning signs in your stocks—signs that someone who does *not* use charts simply *cannot* see. Over time, it will become increasingly clear what a huge, money-making advantage that gives you.

As you become more comfortable with charts, you'll discover other techniques that help you move to the sidelines and safeguard your profits. But to get started, let's take a look at 3 common signs of trouble.

- ☒ *Biggest single-day price decline since start of stock's run on heaviest volume in months*

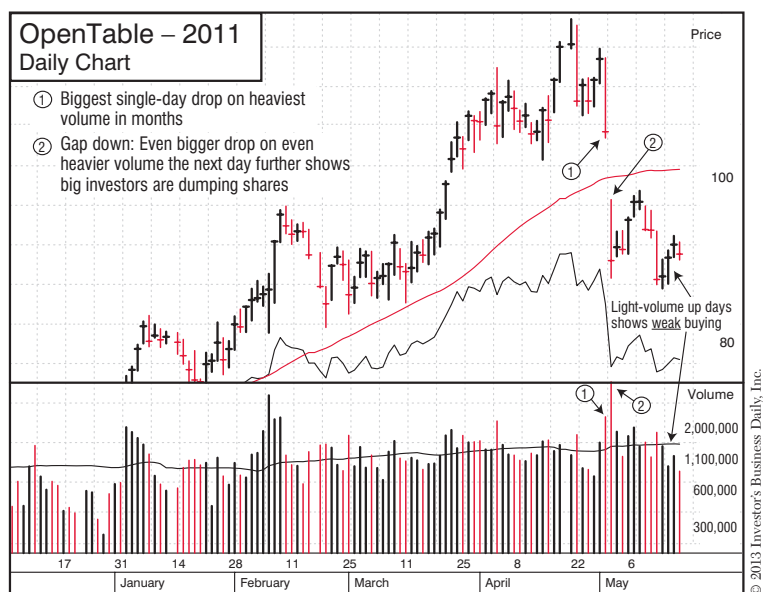
Let's see: A *huge decline* on the *heaviest volume* in months . . .

There's no mystery to that “story.” Institutional investors are aggressively dumping shares!

Some fund managers may be liquidating their positions, and that spells serious trouble for the stock—and for *you* if you continue to hold.

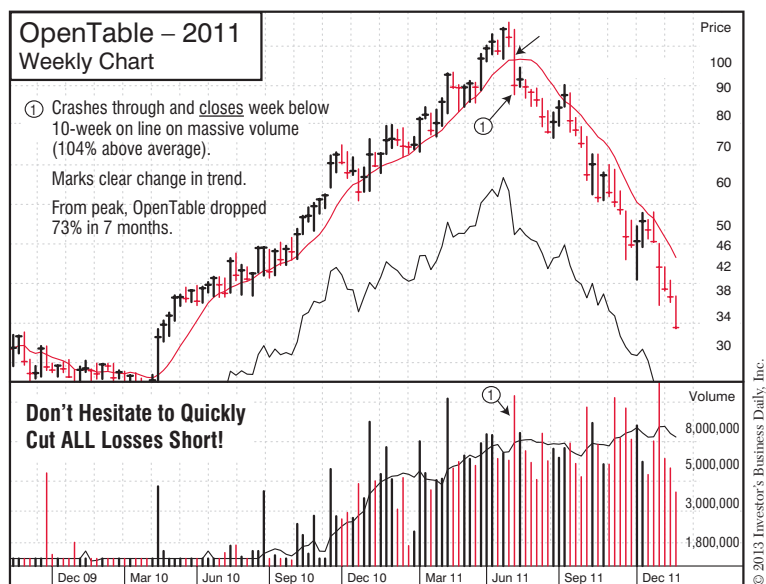
The stock may bounce back down the road, but that type of sudden sell-off is a trend-changer: Chances are high the stock will continue to move farther south.

In the context of this sell rule, let's revisit the charts we saw for OpenTable earlier in "Chart-Reading 101." The company had carved out a profitable niche with a new platform that lets restaurants take online reservations and market to their customers. It was a young, innovative company and a market leader—until its trajectory changed sharply in the spring of 2011.



A huge price drop on heavy volume shows big investors are aggressively selling.

Here's what that looked like on OpenTable's weekly chart.

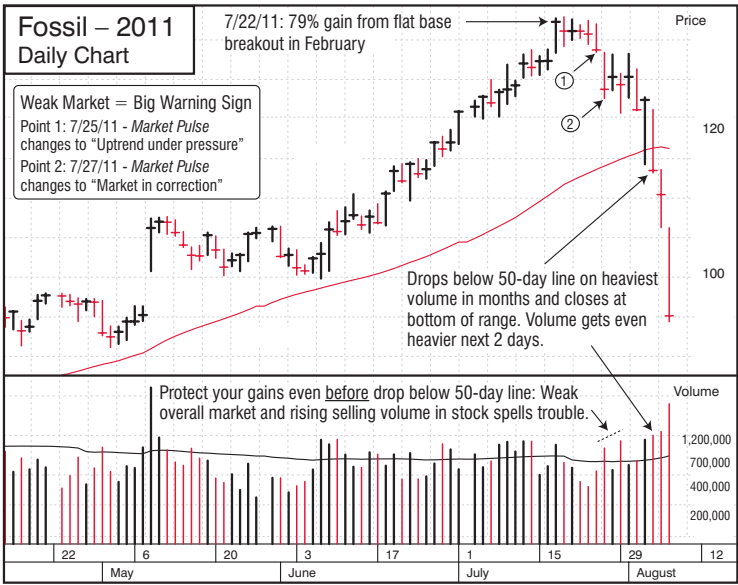


Do you see how the trend changed on that big sell-off?

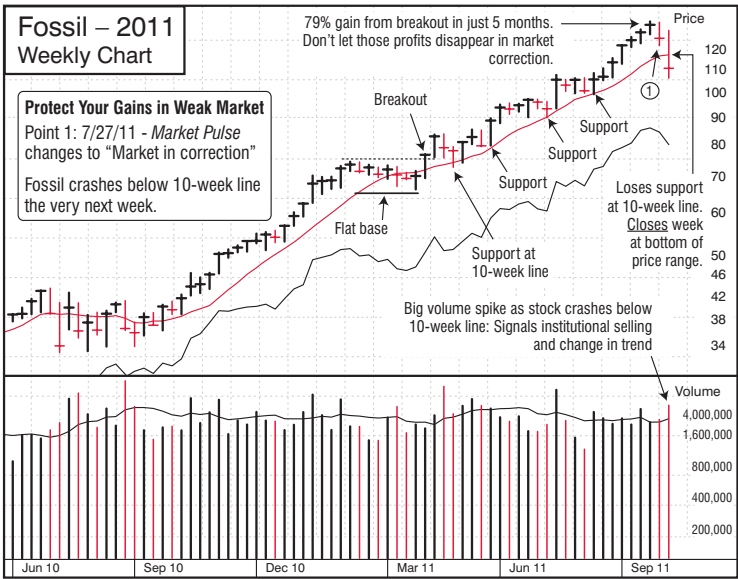
As briefly noted in the charts for OpenTable in “Chart-Reading 101,” there were other warning signs even *before* the stock flashed this sell signal. Learning to spot those is definitely helpful, but as you're getting started, at a minimum, stick to this rule. If a stock makes this kind of sharp downward shift on the heaviest volume in months, it's time to sell at least some of your shares.

What About Overall Market Conditions?

A vital part of the Selling Checklist is to make sure you take defensive action when the overall market starts to weaken. As the following examples for Fossil show, warning signs and sell signals often appear in individual stocks as distribution days mount and the market uptrend slips into a correction. Paying attention to those signs can help you lock in your profits and move to the sidelines before any serious damage hits.



Be ready to lock in profits as the overall market weakens.



Double whammy: The market is in a correction and your stock is selling off on heavy volume. Time for defensive action.

The Trend Is No Longer Your Friend

Take another look at the weekly charts for OpenTable and Fossil—and recall what we learned earlier about support and resistance.

In the months leading up to the sharp sell-off, both stocks had been making a relatively steady upward climb, finding nice support at their 10-week moving average lines.

Do you see how that changed when the stocks suddenly made those exceptionally sharp declines on unusually heavy volume? Don't ignore such a change in trend—it's usually a sign of even more trouble ahead.

 *Sharp drop below 50-day moving average line on heaviest volume in months*

As we saw in the section on support and resistance, professional investors often use the 50-day moving average line as a key benchmark. That's why it's so important to watch how a stock behaves when it trades near that line.

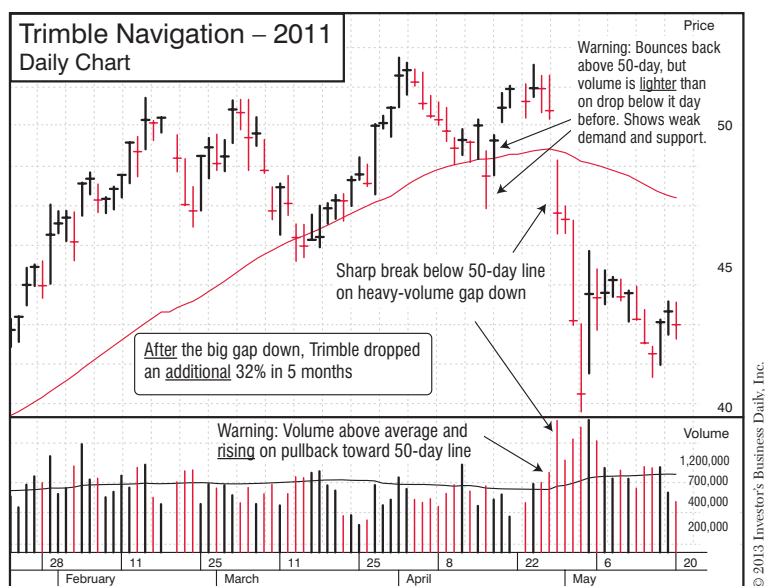
- If the stock stays *above* the 50-day line, that means professional investors are stepping in to support the stock and protect their positions.
- If the stock crashes sharply *below* the 50-day line on *unusually heavy* volume, that could mean institutions are reducing their holdings, and more selling will follow.

A drop below the 50-day line does *not* necessarily mean you should automatically sell your entire position. However, it is a definite warning sign, particularly if the stock:

- Slices *sharply* below the line (especially on a huge gap down)
- Closes at the very bottom of the day's price range
- Declines on unusually heavy volume

Also, if the general market is weakening and the *Market Pulse* outlook has changed to "Uptrend under pressure" or "Market in correction," that's all the more reason to take defensive action and protect yourself.

Next is an example of a heavy-volume drop below the 50-day line.



Support or sell-off? Always watch how a stock behaves around the 50-day line.

Beware the Gap Down!

In “Go Beyond Just the Shapes,” we saw why a big gap *up* on heavy volume is a good thing. It shows there’s so much demand for a stock that, instead of moving up incrementally, it instantly jumps to a much higher price.

But a heavy-volume gap *down* is a completely different story. It tells you institutions are so eager to *sell* that the stock instantly drops down to a much *lower* price.

Take a minute and go back to the *daily* charts above for OpenTable and Trimble. Do you see the heavy-volume gap downs they had—and how the stocks went even farther south after that? If you ever see that behavior in one of *your* stocks, it’s definitely a sign to reduce your exposure and sell some or all of your shares.

✓ Sharp drop—and **close**—below 10-week moving average line on heavy volume

The 10-week moving average line found on weekly charts is roughly equivalent to the 50-day line found on daily charts. While professional investors use both lines as benchmarks (and you should too!), the 10-week line makes it easier to see the longer-term trend.

As we just saw, if a stock drops sharply below the 50-day line on extremely heavy volume and closes at the bottom of its range, that's a serious sign of trouble. On the other hand, if volume is light and the stock bounces back to close near the *top* of the day's range and at or just below that benchmark line, it could mean funds are buying shares to prop up the stock and protect their positions.

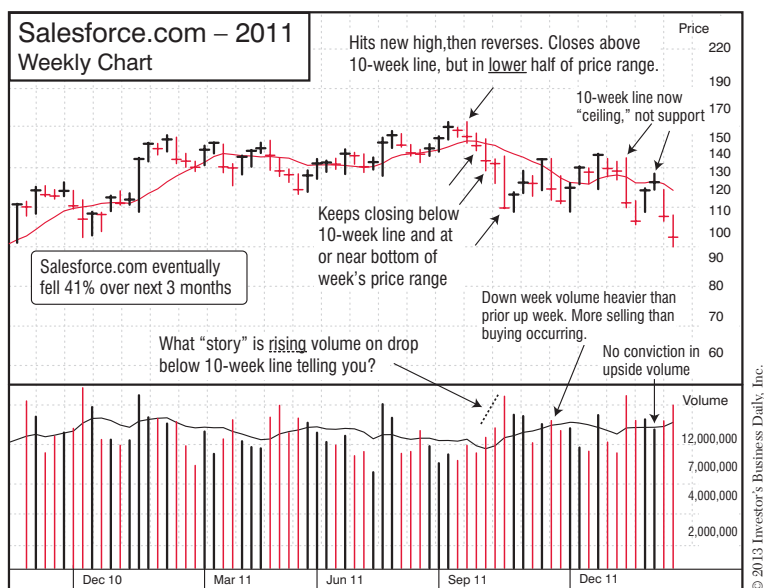
To gauge how serious the selling is, also check the *weekly* chart.

Where Does the Stock *Close* for the Week?

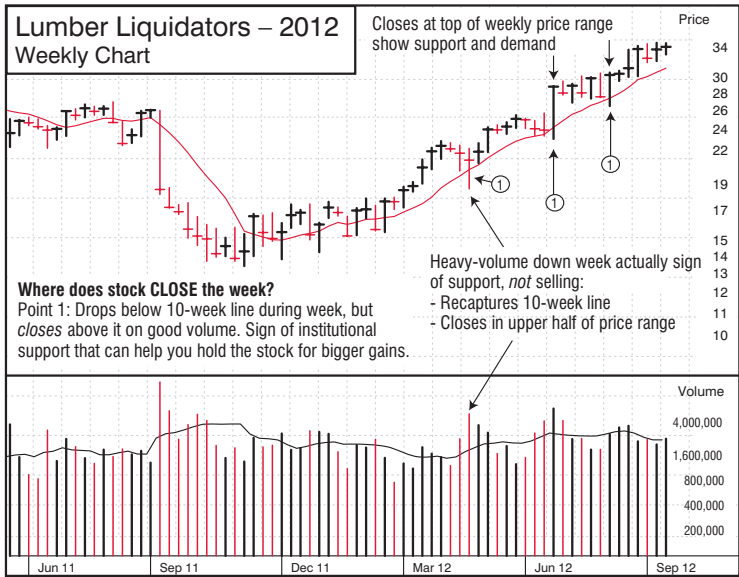
You may find that after a day or two of selling, fund managers step in to buy shares, and by the end of the week, the stock closes above or just under the 10-week line. That's a sign of *support*.

However, if the stock breaks sharply below the 10-week line and *closes* under it on *heavy* volume, that's a sign of institutional *selling*, not support. It's often a precursor to *more* selling, meaning it's time to protect yourself.

Here are two examples. The first shows a stock that did *not* find support and *closed* below the 10-week line on heavy volume. The second shows one that bounced back by the end of the week.



Salesforce.com did not find support at 10-week line, and continued lower.



Waiting to see where the stock *closes* for the week
can help you hold on for bigger profits.

Checking the Chart for Sell Signals



See a short video on how to spot signs of trouble using daily and weekly charts
at www.investors.com/GettingStartedBook.

7

• CHAPTER •

More Tips and Tools for Getting Started Right

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How Many Stocks Should You Own?

“Many investors over-diversify. The best results are usually achieved through concentration, by putting your eggs in a few baskets that you know well and watching them carefully.”

—WILLIAM J. O’NEIL, IBD CHAIRMAN AND FOUNDER

There is no magic formula that determines exactly how many stocks you should own. But here are some basic guidelines to keep in mind.

- ✓ *Don’t own more stocks than you can handle properly and watch carefully.*

I remember talking with an investor at a Money Show years ago who told me she owned over 60 stocks! Who has time to keep tabs on 5 *dozen* different positions? Not me! And not anyone else I know at Investor’s Business Daily either—including Bill O’Neil.

So before you jump in and start buying a bunch of stocks, ask yourself a simple question: *How much time will you realistically spend on investing each week?*

Let’s say you only have 10–20 minutes a day and some more time on the weekend. That is *definitely* enough to go through the simple routines (Chapter 4) and start generating good profits—if you limit yourself to a *few* top-rated stocks.

Remember what I keep saying about keeping it simple. That also goes for the number of stocks you own.

Start small. If you find you can handle more stocks down the road, fine. But definitely don’t buy more stocks than you can manage successfully when you’re just getting started.

- ✓ *Diversify for the right reasons.*

Diversification is not a bad thing, per se. The problem is, too many investors diversify for all the *wrong* reasons—and that’s what gets them into trouble. Here are some examples.

- **Diversification can dilute your results.** Your goal is to have your biggest *winners* also be your biggest *positions*. If you get a 100% gain in a stock that is only 1 of 20 different positions in your portfolio, it's a nice percentage gain—but it doesn't make you any significant *money*.
- **Over-diversification can lead to buying some stocks with less potential or lower quality.** Will you really achieve *superior* results by buying *inferior* stocks? Be picky, and only invest in top-rated stocks that pass the Buying Checklist.
- **Over-diversification does *not* protect your portfolio.** Here's why the idea of "safety in numbers" doesn't apply to your portfolio.

First, it's *much* harder to spot early warning signs if you have to constantly track 15 or 20 stocks. But you can do it very quickly if you only need to check in on 3 or 4 positions.

Second, when you *own* a lot of stocks, you also have to *sell* a lot of stocks to protect your overall portfolio. If you own 20 stocks, will you really sell 10 or 15 of them quickly enough to avoid serious damage?

Remember: A market downtrend will take 3 out of 4 stocks down with it. Owning a bunch of stocks doesn't change that fact—it just makes it that much harder to reduce your risk.

On the other hand, if you own 3 or 4 stocks, you only need to sell 1 or 2 to quickly safeguard a significant portion of your money.

So What Are the *Right* Reasons to Diversify?

The main one is to avoid putting all your money into *one* industry.

For example, if you own nothing but semiconductor stocks or nothing but housing stocks—both of which are cyclical industries—you're taking on undue risk. If bad news or an economic downturn suddenly rocked the industry, *all* of your stocks might instantly sell off.

Stocks move in *groups*. If institutional investors start pumping money into a particular industry, stocks in that business will generally go up. And when fund managers decide they want out, *all* stocks in that group are at risk.

In Bill's quote at the beginning of this chapter, he didn't say put *all* your eggs in *one* basket. The point is that you don't want to diversify just because people say diversification is "good" or "safe." Instead, concentrate on a few stocks in a "few" baskets—and watch them very carefully.

A General Guideline for How Many Stocks to Own

Based on the concepts above, here is a basic rule of thumb for how many stocks to have in your portfolio.

Portfolio Size	Suggested Number of Stocks
Under \$20,000	2–3 Stocks
\$20,000–\$200,000	4–5 Stocks
\$200,000–\$1 million	5–6 Stocks
\$1 million–\$5 million	6–8 Stocks
Over \$5 million	7–10 Stocks

Set a Maximum Number, and Stick to It



As part of your investing game plan, decide the maximum number of stocks you'll own at one time. When you reach that cap, stay disciplined: Before you buy another—presumably *better* stock—sell your *weakest* holding to make room for it.

Bottom line: Be selective and only buy a few top-rated CAN SLIM® stocks that pass the Buying Checklist, then watch them very closely. That's a more manageable way to grow your portfolio.

How to Build and Maintain an Actionable Watch List

“It takes as much energy to wish as it does to plan.”

—ELEANOR ROOSEVELT

Superior results start with a superior watch list. So here are 4 steps you can take to build and regularly refresh *your* list.

Keep in mind: This is just one possible approach you can use to get started. Find whatever approach works best for you.

 *Create 2 watch lists.*

- **Near Buy Point:** For stocks near a potential buy point or in buying range *right now*.

To keep this list actionable, be sure to prune it regularly so it doesn't get cluttered with stocks *not* currently near a buy point.

- **Radar Screen:** For stocks with CAN SLIM® traits that are *not* near a buy point right now.

You want to keep an eye on these because they could offer a buying opportunity later.

How Do I Set Up a Watch List?

Most people set them up using tools from their online broker or trading platform. Ask your brokerage service what watch list tools they offer.

How Many Stocks Should I Have on My Lists?

Set a limit on how many stocks you'll have on each list. For a watch list to be valuable, it has to be actionable. So stick to a *manageable* number of stocks. You might limit your Near Buy Point list to 5–10 stocks and your Radar Screen list to 15–20. The number depends on how much time you have to spend on research.

Don't hesitate to be picky! Only keep stocks that pass the Buying Checklist with flying colors on your list. Over the long term, focusing on the strongest stocks will generate the biggest returns.

 *Use the Simple Weekend Routine and IBD tools to find quality stocks.*

- See “Simple Routines for Finding Winning Stocks” (Chapter 4) and “More Ways to Find Winning Stocks” (later in this chapter).
- Run the most promising stocks through the Buying Checklist. If they pass, add them to your Near Buy Point list. If a stock has the CAN SLIM traits but is not currently near a buy point, you can add it to your Radar Screen list.

 *Make a game plan for stocks on your Near Buy Point list.*

To catch a stock as it breaks out, you need to make your game plan *ahead of time*. It'll often be too late if you wait until *after* the stock has begun its move.

At a minimum, be sure to note:

- The ideal buy point
- How many shares you'll buy if the stock breaks out on heavy volume

Trade triggers: You can also set up automatic trade triggers ahead of time if you can't watch the market during the day (Chapter 4).

Earnings season: Check when a stock you're tracking is scheduled to report. Stocks can make a big move—up or down—when they release their latest numbers (Chapter 3).

 *Review and refresh your watch list regularly.*

Your watch list will only be actionable and effective if you keep it focused and up to date.

- Regularly refresh your list as part of your weekend and/or daily routine.
- If you've reached the maximum number of stocks you set for your list, be sure to remove your weakest stock before you add a new one.

- When in doubt about what to keep or cut, focus on the “big rocks”:
 - Which stock has the biggest earnings growth?
 - Which company has the most innovative product or service dominating its industry?
 - Which stock is being most heavily bought by institutional investors?

Maintain Your Watch List in Strong *and* Weak Markets

Keep building and refreshing your watch list *even if the market is in a downturn*. The best stocks form bases during a correction, then *quickly* shoot higher when a new uptrend begins. To catch these winners and make big money when the market is *up*, you need to prepare while the market's *down*.

• ACTION STEPS •

To take these steps, visit www.investors.com/GettingStartedBook.

- Watch my *2-Minute Tip* video: *5 Steps to Building & Maintaining a Profitable Watch List*.
- Create your watch lists: Near Buy Point and Radar Screen (or whatever setup works for you).
- Start *regularly* doing the simple routines to find new stock ideas (Chapter 4).
- Make a game plan for stocks on your Near Buy Point list.

How to Do a Profitable Post-Analysis

“The only way you get a real education in the market is to invest cash, track your trade, and study your mistakes.”

—JESSE LIVERMORE, LEGENDARY INVESTOR

Even the best investors make mistakes—but they learn from them. That’s why after decades of investing, IBD founder Bill O’Neil and his portfolio managers *still* regularly do a post-analysis of their trades. It’s simply the best (perhaps, the *only*) way to become a successful investor over the long term. So make sure you keep good records of your trades and review them at least once a year.

We’ll get into 2 ways to help you do that:

- 5 questions to help you do a profitable post-analysis
- Improve your returns by improving your records

Finding and fixing *just one or two common mistakes* can have a huge impact on the amount of profits you make. Maybe you’re buying stocks when the overall market is weak or holding your stocks a little too long.

Whatever the issue, *don’t get discouraged*. Each time you address one of yesterday’s pitfalls, you add that much more to tomorrow’s profits.

Start with—and Stick to—Basic Rules



You can easily avoid many common pitfalls from the start simply by following the buying and selling checklists found in this book.

5 Questions to Help You Do a Profitable Post-Analysis

These basic questions will help you pinpoint any habits that need to be addressed.

1. Was the market in an uptrend when you bought the stock?

Don’t fight the market! When the market is in a correction, it will take most stocks down with it. So keep the odds in your favor: Only buy stocks when the *Market Pulse* outlook says “Confirmed uptrend.”

See *Big Rock #1* (Chapter 3).

2. Did the stock have CAN SLIM® traits when you bought it?

Always start your search for tomorrow's big winners by looking for stocks that have the 7 CAN SLIM traits and the "big rocks" we discussed: Focus on stocks that have big earnings growth, new innovative products and are being heavily bought by institutional investors.

See the Buying Checklist (Chapter 3).

3. Did you buy at a proper buy point?

Most winning stocks launch their big moves as they break out of a cup-with-handle, double bottom or flat base. If you don't use charts to identify those money-making opportunities, you're putting yourself at a serious disadvantage. Charts prove that "timing really is everything."

If you ran into trouble with the stock, go back and see if it passed the Buying Checklist *at the time you bought it*:

- Did you buy too *late*—after the stock was already over 5% past the ideal buy point?
- Did you buy too *early*—trying to *anticipate* a breakout?
- Was volume at *least* 40%–50% above average at the breakout?
- Was it a late-stage base?
- Were there serious flaws in the base, such as wide and loose action or excessive distribution (selling)?
- Did you hold a stock because it had good earnings growth and a great product—even as the stock fell lower and the chart flashed clear sell signals?

Whatever the issue is, don't *dwell* on your mistake—*fix* it! A good starting point is to always make sure a stock passes the Buying Checklist before you buy.

See the Buying Checklist (Chapter 3) and Don't Invest Blindly (Chapter 6).

4. Did you follow sound sell rules?

Maybe your emotions took over, and you let a little loss become a big one. Or maybe you sold too *soon*—and a stock you used to own went on to huge gains without you.

That's frustrating, but here's the good news: All those issues can be fixed by following some time-tested sell rules. And you can start applying the most important ones right now by using the Selling Checklist.

See the Selling Checklist (Chapter 5).

5. Did you continually weed out laggards and focus your money on your best-performing stocks?

One common—and costly—mistake many investors make is they sell their *winning* stocks and hold onto their *laggards*. That's exactly the *opposite* of what you want to do. To build a winning portfolio, always shed your weak or losing stocks first.

Cut all losses short, and look for chances to steer money into your best-performing stocks when they form a 3-weeks tight or other alternative buy point. In other words: Maximize your returns by making your *biggest gainers your biggest positions*.

See the 8 “Secrets” of *Successful Selling* (Chapter 5) and *Alternative Buy Points* (Chapter 6).

Turn Your Past Mistakes into Future Profits

If you ask these questions for each of your trades—and answer them honestly!—you'll avoid making the same mistakes in the future. That's how you generate even bigger profits for the rest of your investing career.

• ACTION STEPS •

To take these steps, visit www.investors.com/GettingStartedBook.

- Watch my *2-Minute Tip* video: *5 Questions to Help You Do a Profitable Post-Analysis*.
- Use the questions above to review any trades you've made in the last 12 months.

Improve Your Results by Improving Your Records

“You can’t manage what you don’t measure.”

—W. EDWARDS DEMING

Your online broker keeps a basic record of your trades—purchase price, number of shares, etc. But to systematically improve your skills and returns, you’ll want to personally keep a more detailed account of every buy and sell. As you’ll see, it’s *very* easy to do, and the payoff is definitely worth the extra little effort.

As we just saw, regularly reviewing your trades is essential to your success. Having good records of your trades makes doing that review *so much* easier and faster.

Plus, *writing down* your reasons for the trade at the time you make it will help prevent rash buy and sell decisions. It forces you to step back and make sure you’re sticking to the buying and selling checklists. Trust me—you’ll be a lot more confident and comfortable if you have a sound rationale for making that trade *before* you make it.

Here’s a simple way to keep a snapshot of what each stock looked like when you bought or sold it. If you follow these steps, you can always go back and see what the chart action, ratings, earnings and other key criteria looked liked at the time of your trade.

Tracking Your Buys

Every time you make a buy, print out the following for each stock:

- *Daily and weekly* chart
- Current *IBD Stock Checkup*

You can print these out and keep them in a binder. I prefer to create PDF documents and store them on my computer. I find that easier to organize, but the format doesn’t matter. Do whatever works best for you. What’s important is that you keep a detailed record of what was happening with the stock at the time of your purchase.

Here's the nice thing about printing out *Stock Checkup*: It does most of the work for you! Just print it out, and you have a permanent snapshot of what was happening at the time you bought the stock.

You'll find pass, neutral or fail ratings for:

- Market direction: Uptrend or correction?
- Your stock's fundamental performance (earnings and sales growth, return on equity, etc.)
- Your stock's technical performance (fund ownership, Relative Strength Rating, etc.)

It takes all of about 2 seconds and makes doing a post-analysis *much* easier.

Here are some other things you want to note. I add them as "comments" on the chart PDFs I create, but you could also just grab a pen and write them down on your printouts.

- **Basic info**

- Date of purchase, number of shares purchased, cost per share.

- **Base and buy point**

- Note the type of base (e.g., cup-with-handle) or other buy point (e.g., pullback to 10-week moving average line), and *draw it on the chart*.

- **Any yellow flags?**

- Examples: Lower than ideal sales growth, a slightly weak industry group ranking, etc.

- **Primary reasons for buying**

- Examples: Breakout from cup-with-handle on heavy volume; new innovative product; emerging industry trends, etc.

- **Target sell prices**

- Offensive: Typically 20%–25% above *ideal* buy point
- Defensive: Typically 7%–8% below *your* purchase price

Tracking Your Sells

Just like when you buy a stock, print out the following every time you sell:

- *Daily* and *weekly* chart
- Current *IBD Stock Checkup*

Selling is one of the toughest parts of investing. But if you follow the Selling Checklist and get in the habit of keeping good records, you'll be surprised how quickly you become more adept at locking in profits at the right time.

Be sure to write down the following:

- **Basic info**
 - Date of trade, your sell price, number of shares sold, number of shares you still own *after* the sale (if any), your % gain or loss
- **Reasons for Selling**
 - Examples: Hit target of 20%–25% above ideal buy point; fell 7% below what you paid for it; crashed below 50-day moving average line on the heaviest volume in months, etc.

Good Records Lead to Good Habits

To make money over the long term, you need good habits and routines. You can do that just by following the simple routines and checklists we covered earlier and by keeping detailed records so you're able to properly review your results.

Just as athletes watch past games to improve their skills, as investors, we all need to review our past trades. But to do that, you need to have the “game tape”—and you will if you follow the steps above. Then you'll be ready to do a quick and profitable post-analysis to minimize any mistakes and build on your successes.

• ACTION STEPS •

For more information on how to keep good records and do a regular post-analysis, visit investors.com/GettingStartedBook.

- Set up a binder or other filing system for keeping records of your trades.
 - If you're going to create PDF documents instead, set up a folder on your computer to store the records.
- Start keeping records of *all* your trades!

More Ways to Find Winning Stocks

IBD's stock lists, ratings and other features all have one common goal: To alert you to today's best stocks.

You'll find today's top performers in IBD's lists because they screen the entire market, looking for stocks with CAN SLIM® traits—the 7 characteristics the biggest winners typically have just *before* they launch a major price move. Those are the same traits found on the Buying Checklist (Chapter 3).

Keep It Simple

We've already touched on some of the features we'll get into here—*IBD 50*, *Your Weekly Review*, *Sector Leaders* and others.

If you're busy, I suggest you start by using the tools and stock lists we covered as part of the Simple Weekend Routine and 10-Minute Daily Routine (Chapter 4). You can dig into other features as you get more comfortable with IBD and investing in general.

Look at Me! Look at Me!

Pay special attention to any stocks that keep popping up on multiple lists. There's a reason that happens: These stocks are the true market leaders with the potential to double or triple in price.

They say “the squeaky wheel gets the grease.” Here's just one example of how the “squeaky stocks” get the profits:



Lululemon Athletica: 196% gain in just 10 months

The yoga apparel retailer launched that explosive price move when it broke out of a double bottom on September 14, 2010. Here are just a few of the places Lululemon was screaming “Look at me!” to anyone using IBD and the **Simple Weekend Routine** (Chapter 4).

- For well over a month *before* its breakout, Lululemon was continually featured in the *IBD 50* (*IBD 100* at the time) and highlighted as a **Sector Leader**.
- **June 7, 2010:** Featured in the *Daily Stock Analysis* video.

- **September 10, 2010:** Four days *before* it launched its 196% run, Lululemon made a massive 13% gap up on volume 612% higher than normal—a clear sign big investors were buying *heavily*.

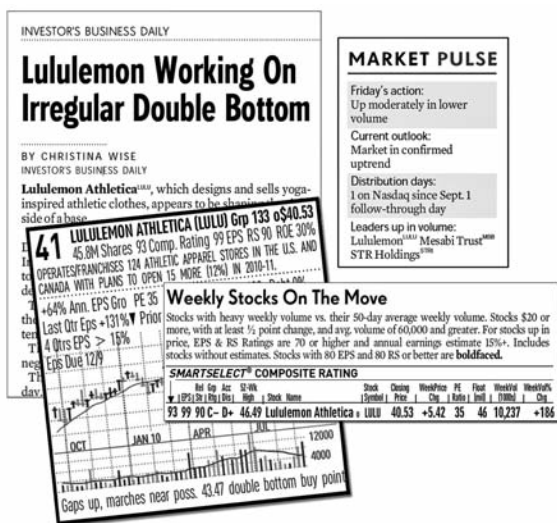
That was a Friday, so when you did your Simple Weekend Routine, here are just some of the features that would have alerted you to that move:

- *The Big Picture*
- *Stocks on the Move*
- *Smart Table Review*
- *IBD 50*

- **September 13, 2010:** Doing your **10-Minute Daily Routine** (Chapter 4), you would have seen Lululemon highlighted again in *The Big Picture* and *Stocks on the Move*.

- **Key Points:**

- All these mentions of Lululemon came *before* it broke out and shot up 196% in just 10 months.
- That gave you plenty of time to have the stock on your watch list (“How to Build and Maintain an Actionable Watch List” in this chapter) and set up a trade trigger (Chapter 4) with your broker to make sure you caught Lululemon right when it launched its move.



Lululemon Athletica was highlighted in IBD multiple times *before* it surged 196% in 10 months.

In every strong market uptrend, you'll find similar examples. So while they say good stocks are hard to find, in IBD they're hard to *miss*! You'll see what I mean when you start using the stock lists and features highlighted below.

Never Buy a Stock *Just* because It's Featured in IBD!



These are *not* recommendations. The purpose is to alert you to stocks showing the most potential. Always make sure a stock passes the Buying Checklist before you invest.

The Big Picture

As we've seen repeatedly in this book, since most stocks simply move in the same direction as the general market, successful investing starts with one basic question: Is the market currently heading up—or down?

You can always find the answer by checking the *Market Pulse* in *The Big Picture* column.

Here's another thing you'll find in the *Market Pulse*: **Leaders up in volume.** As you scan *The Big Picture* during your daily or week-end routine, be sure to check that to see which top-rated stocks made a big move that day. That could be signaling the *start* of a nice run.

THE BIG PICTURE

Stocks Deliver Nice Finish; Distribution Count Drops

BY VICTOR REKLAITIS
INVESTOR'S BUSINESS DAILY

Stocks displayed positive action by rallying into the close Tuesday, starting a holiday-shortened week with moderate gains.

The tally of distribution days, which are sessions with significant selling, also moved in the right direction.

The Nasdaq lost its Dec. 13 distribution day, because enough time has passed that it's no longer relevant. That leaves the Nasdaq and NYSE with four distribution days, while the S&P 500 has just three.

The NYSE fared best Tuesday, climbing 0.5%. The S&P 500 added 0.4%. The Nasdaq tacked on 0.3%, after spending most of the session in negative territory.

In economic news, the National Association of Realtors said existing-home sales slowed to an annualized rate of 4.94 million in December, missing forecasts.

But the report didn't hurt the

ly rated railroad, leapt 5% in heavy volume after its quarterly earnings beat estimates. The stock gapped up beyond a buying range established by a recent buy point at \$4.08.

On the downside, SodaStream InternationalSM tried to break out from a three-weeks-tight pattern.

The Israel-based maker of in-home soda machines popped as much as 6% intraday in fast trade, clearing a \$0.08 buy point, then closed below that level with a 2% gain.

After the market's close, several big names delivered upbeat quarterly earnings reports.

MARKET PULSE

Tuesday's action:
Rallies into the close
as volume falls

Current outlook:
Confirmed uptrend

When & Where

Daily in the *Making Money* section of IBD and on Investors.com

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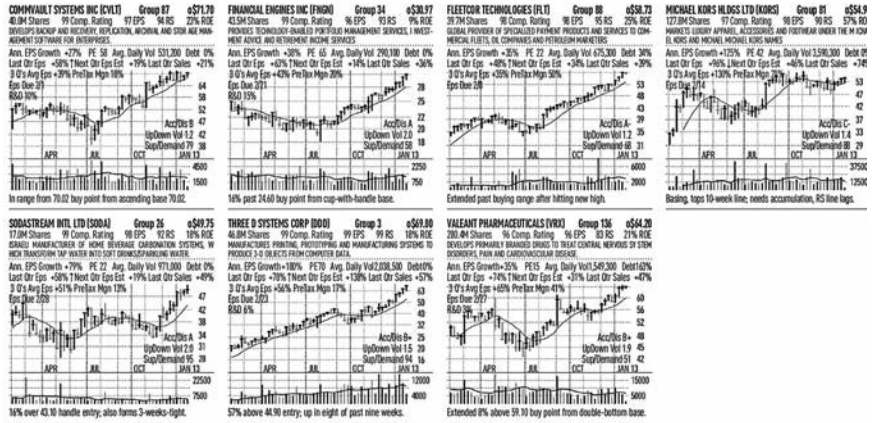
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Sector Leaders

Sector Leaders Charts



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As the name suggests, this list features the top-rated stocks within their respective industry sectors. To be counted as a sector leader, a stock has to pass a tight screen that looks for exceptional earnings growth, return on equity and other vital factors. Because it's such a demanding screen, only a few of IBD's 33 sectors will have a company that qualifies as a leader.

To get more insight into the current sector leaders—what they do, industry trends, potential buy points—see the *Smart Table Review* column, found daily in the *Making Money* section of IBD and on Investors.com.

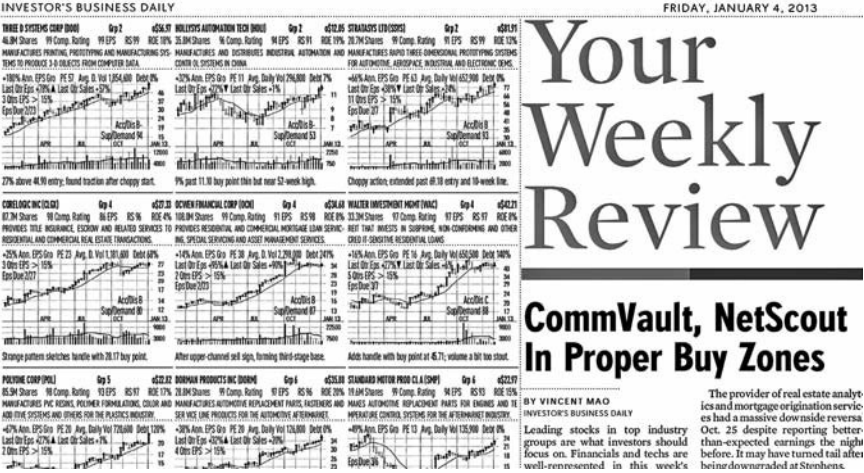
Like in the *IBD 50*, a chart with alerts to any potential buy points is included for each stock.

When & Where

Daily in the *Making Money* section of IBD

The related *Smart Table Review* column is also available on Investors.com

Your Weekly Review



Your Weekly Review highlights stocks that have 2 of the most important factors to look for:

- **85 or higher score for both EPS and RS Ratings**
- **A top-rated stock in a top-ranked industry group**

Stocks on *Your Weekly Review* are sorted by industry group ranking, so you'll find the leading stocks in the higher-ranked groups at the top of the list.

Like in the *IBD 50* and *Sector Leaders*, a chart with alerts to any potential buy points is included for each stock.

You'll also find a related column that provides more insight into the stocks on this list.

When & Where

Fraturdays in the A section of IBD
The *Your Weekly Review* column is also available on Investors.com

INVESTOR'S BUSINESS DAILY

MONDAY, FEBRUARY 4, 2013 B9

BY SCOTT STODDARD
INVESTOR'S BUSINESS DAILY

Alkermes^{ALX}, The Medicines Co., **Alkermes^{ALX} and Regeneron^{REG}** are in the 236-member Medical-Biomedical/Biotech industry group, a longtime leader that was ranked as No. 32 out of 197 industries as of Friday's IBD.

IBD 50 stock The Medicines Co., a developer of heart and blood-thinning drugs, is well out of the buying range after breaking out of a cup base Jan. 8 in huge trade.

The breakout came after **Medicines Co.** reported positive results for its anti-clotting drug **cangrelor** in a late-stage clinical trial.

The company said it plans to file for approval of **cangrelor** this year and begin sales in 2014.

The biotech announced Jan. 11

D R HORTON INC (DHI)	Group 12	c\$23.35
99 Comp. Rating 80 EPS \$5.89 ROE 31% 289.2M Shares		
BUILDS SINGLE-FAMILY DETACHED HOMES FOR FIRST-TIME AND MOVING-UP HOMEBUYERS IN 35 STATES AND 71 METROPOLITAN MARKETS.		

OCWEN FINANCIAL CORP (OCN) Group 6 o\$39.66
99 Comp. Rating 90 EPS RS 99 ROE 8% 108.0M Shares
PROVIDES RESIDENTIAL AND COMMERCIAL MORTGAGE LOAN SERVICING SPECIAL SERVICING AND ASSET MANAGEMENT SERVICES.

NEUSTAR INC (NSR)	Group 23	e\$45.84
99 Comp. Rating 97 EPS RS 86 ROE 29% 65.0M Shares		
PROVIDES CALL ROUTING, DATABASE INFRASTRUCTURE SERVICES AND NETWORK MANAGEMENT FOR TELECOM AND ENTERPRISE MARKETS.		

ON ASSIGNMENT INC (ASGN) Group 7 e\$24.90
99 Comp. Rating '93 EPS RS % ROE 11% 48.0M Shares
PROVIDES PERMANENT AND TEMPORARY IT, HEALTHCARE AND LAB
SUPPLY SORT STAFFING TO 5,340 CLIENTS VIA 74 OFFICES IN 24 STATES

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Be sure to also read the article that accompanies the list. It typically features 1 or 2 stocks from that day's list, noting any potential buy points or other key news.

Daily in the *Making Money* section of IBD

The *Stock Spotlight* article is also available on [Investors.com](https://investors.com)

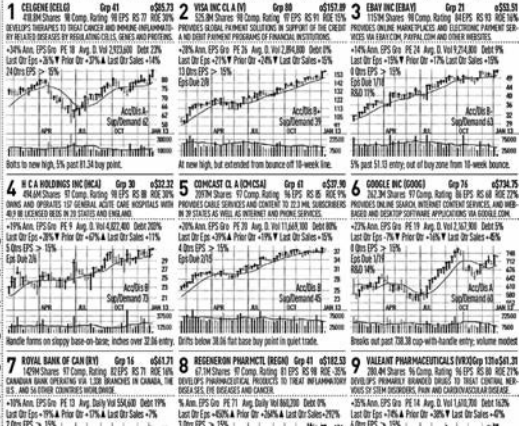
IBD Big Cap 20

A10 TUESDAY, JANUARY 8, 2013

INVESTORS.COM



SMARTSELECT® COMPOSITE RATING										High Speed	
Rank	Company	Price	1Yr %Chg	3Yr %Chg	5Yr %Chg	10Yr %Chg	ROE (avg)	% I	Div	High Speed	
1	Celgene	85.73	98	97	77	+28	+26	+25	14	30	44
Working on treatments for breast cancer, arthritis, other illnesses.											
2	Visa Inc CIA	157.9	98	97	91	+17	+21	+20	+15	15	60
Shift from cash, partnerships with banks help drive growth.											
3	EBay Inc	53.51	98	84	93	+15	+15	+15	+15	16	28
Its PayPal and Marketplace units are stoking growth.											
4	HCA Holdings	32.32	97	98	88	+27	+28	+12	+11	30	10
Hospital operator announced a \$2.50/shr special dividend in October.											
5	Comcast CIA	37.90	97	96	85	+22	+29	+13	+15	9	15
Broadband business helping to offset weakness in video.											
6	Google Inc	734.8	97	86	68	+10	-7	+11	+45	22	39
Dominates website advertising, and now mobile advertising, too.											



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IBD Big Cap 20 highlights the top growth stocks with a market capitalization of at least \$15 billion.

While all stocks can be volatile, the larger, more established companies that make this list tend to be more conservative and less susceptible to big price swings than smaller cap growth stocks.

For each IBD Big Cap 20 stock, you'll find the same type of chart found in IBD 50 and Your Weekly Review, with alerts to any potential buy points.

Also look at the Inside Big Cap 20 column for additional insight into selected stocks and the latest trends affecting the list.

IBD Big Cap 20 can help you reduce volatility in your portfolio but still offer the potential for substantial gains.

When & Where

Tuesdays in the A section of IBD

The Inside Big Cap 20 column is also available on Investors.com

Stocks On The Move

NYSE Stocks On The Move

Stocks with high volume vs. 50-day avg. show heavy institutional action. 80 EPS & RS or better + closing price up are **boldfaced**.

Comp EPS Rel Acc 52-Wk Rtg [Rnk] [Str] [Dis] High	NYSE Stock	Stock Symbol	Closing Price	Chg	Vol	Vol% [(1000s)] Chg
99 93 93A-20.93	OnAssign	ASGN	22.00	+1.72	1,153	+296
86 73 76A-42.79	Circo	CIR	40.21	+0.62	207	+209
96 80 85B-70.86	CytecInd	CYT	70.92	+2.09	1,141	+179
94 84 94B-32.59	PiperJaff	PJC	33.02	+0.89	253	+168
90 89 84C-102.4	Fomento	FMX	101.3	+0.60	1,265	+148
90 77 93B-136.8	PPGIndust	PPG	136.6	+3.20	3,186	+148
98 93 97B-21.00	Polyone	POL	22.20	+1.78	1,885	+138
96 85 81B-39.35	Honda Mtr	HMC	38.36	+1.42	1,223	+138
98 87 92A-65.16	Maxims	MMS	64.71	+1.49	358	+130
99 99 77B-31.66	NeenahPaper	NP	30.60	+2.13	160	+128
80 88 71C-26.93	AquaAmerica	WTR	26.40	+0.98	1,140	+109
99 97 97A-25.61	SouthernHldgs	SFUN	25.99	+0.99	553	+100
99 97 82B-43.85	NeuStar	NSR	43.68	+1.75	770	+91
94 86 87A-55.90	Stapan	SCL	56.08	+0.54	121	+84
96 91 87B-66.66	Ingredion	INGR	67.00	+2.57	970	+81
99 99 95B-37.80	LithiaMt	LAD	39.00	+1.58	507	+81

Nasdaq Stocks On The Move

action. 80 EPS & RS or better + closing price up are **boldfaced**.

Comp EPS Rel Acc 52-Wk Rtg [Rnk] [Str] [Dis] High	Nasdaq Stock	Stock Symbol	Closing Price	Chg	Vol	Vol% [(1000s)] Chg
86 70 92B-34.86	EchoStar n	SATS	35.01	+0.79	386	+216
79 86 73C-40.58	Abaxis	ABAX	37.82	+0.72	269	+145
99 97 96A-35.42	Dorman	DORM	36.57	+1.23	287	+135
93 80 92A-22.33	MnPwSy	MPWR	22.83	+0.55	633	+133
97 73 96A-20.49	AvisBudget	CAR	20.77	+0.95	2,977	+127
77 89 73C-49.75	ElizArden	RDEN	45.88	+0.87	390	+115
91 83 70B-48.50	SilonLab	SLAB	43.52	+1.72	628	+114
90 81 80B-30.18	FightCar	RAIL	23.74	+1.32	129	+109
82 73 73A-25.25	OtterTail	OTTR	25.74	+0.74	180	+109
94 89 85B-56.48	FEI	FEIC	57.77	+2.30	500	+99
99 88 91A-48.13	Sodastrm	SODA	46.84	+1.95	1,884	+95
89 86 91C-40.66	UrbanOutfit	URBN	40.98	+1.62	4,555	+94
89 77 72A-50.76	RBCBear	ROLL	51.22	+1.15	138	+91
89 88 98A-89.13	GeospaceTech	GEOS	89.84	+0.97	206	+86
89 78 78D-22.30	Microsemi	MSCC	21.88	+0.84	855	+78
67 81 71C-34.70	ArgoGpInt n	AGH	34.49	+0.90	127	+75

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Daily print version of Stocks on the Move

Weekly Stocks On The Move

Stocks with heavy weekly volume vs. their 10-week average volume. Stocks \$20 or more, with at least 1/2 point change, and avg. volume of 60,000 and greater. For stocks up in price, EPS & RS Ratings are 70 or higher and annual earnings estimate 15%+. Includes stocks without estimates. Stocks with 80 EPS and 80 RS or better are **boldfaced**.

SMARTSELECT™ COMPOSITE RATING

↓ EPS	Rel Rtg	Acc 52-Wk	High	Stock Name	Stock Symbol	Closing Price	Week Price Chg	PE Ratio	Week Vol (1000s)	Week Vol% Chg
81 71 77 B	B	59.03	Transocean Inc	RIG	51.82	+7.62	16	356	28,570	+165
69 85 77 D	B+	37.25	Sears Roebuck & Outlet	SHOS	35.06	+1.87	14	5.1	811	+151
95 84 95 A	A-	33.80	Piper Jaffray Cos	PJC	33.62	+1.55	19	16	1,018	+148
99 93 94 A	A	22.59	On Assignment	ASGN	22.63	+3.07	23	49	2,846	+118
94 85 77 A	B	39.35	Honda Motor Co Ltd	HMC	37.75	+1.33	17	1.88	4,507	+109
69 78 70 C	B-	20.60	Pinnacle Fin Pntn	PNFP	20.12	+1.42	20	32	1,179	+98
98 93 97 A	A-	22.97	Polyone	POL	23.22	+3.27	20	86	5,603	+90
97 73 96 B	A	21.38	Avis Budget Group	CAR	21.75	+2.37	9	102	10,606	+90
83 91 74 D	B-	51.45	Gartner Inc	IT	48.70	+3.35	30	89	3,729	+87
91 77 93 B	B	140.4	P P G Industries	PPG	139.47	+6.77	18	150	10,013	+81
99 97 96 A	A-	37.19	Dorman Products Inc	DORM	35.88	+1.73	20	29	973	+81
71 88 72 D	C	73.72	Hain Celestial	HAIN	56.32	+3.84	29	43	4,819	+78
94 89 72 A	A-	56.95	Sigmet Jewellers Ltd	SIG	53.87	+0.94	13	80	4,943	+70
99 99 93 B	A	21.99	Viewpoint Financial	VPFG	21.72	+0.88	20	38	1,199	+68

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Weekly print version of Stocks on the Move

IBD Stock Research Tool

MARKET DIRECTION

FIND STOCKS

EVALUATE STOCKS

TRACK STOCKS

Stocks on the Move

↑

↓

Add to My Routine

Watch Video >>

Stocks On The Move

Stocks being BOUGHT heavily by institutional investors.
Click icons for analysis. [Learn More](#)

Symbol	Company	Price	Price Chg.	Price % Chg.	Volume % Chg.	IBD Tools
AMWD	American Woodmark Corp	29.73	1.52 ↑	5.39% ↑	175%	  
BCEI	Bonanza Creek Energy Inc	31.85	1.10 ↑	3.58% ↑	126%	  
SBS	Comp De Saneamento Adr	46.47	1.20 ↑	2.65% ↑	96%	  
RNF	Rentech Nitrogen Pntn Lp	48.40	0.51 ↑	1.06% ↑	55%	  
GEOS	Geospace Technologies	92.91	1.02 ↑	1.11% ↑	28%	  

View All >

Last Update: 02/04/2013 (Market Close)

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Online version of Stocks on the Move

Want an easy way to find stocks being heavily bought by institutional investors *right now*? Check *Stocks on the Move*. It highlights stocks making a big price move on *unusually* heavy volume—a sign of professional trading.

There are 3 different versions of this list:

- Daily print edition
- Weekly print edition
- Online version—updated every minute throughout the trading day

Be sure to check the print or digital edition of IBD at night or on the weekends to see which stocks made a big move that day or week. And if you have time, take a look at *Stocks on the Move* on Investors.com while the market is still open. Both are great ways to get new stock ideas for your watch list.

Since winning stocks tend to start a major new price move by jumping higher on a big spike in volume, *virtually all big winners appear on Stocks on the Move in the early stages of their runs*.

How to Get in Early on Winning Stocks



Learn to spot *future* winners by seeing how you could have found Chipotle Mexican Grill *before* it broke out using *Stocks on the Move*. Take a look at www.investors.com/GettingStartedBook.

When & Where

Stocks on the Move: Daily in the *Making Money* section of IBD

Weekly Stocks on the Move: Mondays in the *Making Money* section of IBD

Online version of *Stocks on the Move*: Home page of Investors.com; updated every minute throughout the trading day

New High List, Stocks Just Out of Bases, Stocks Pulling Back to 10-Week Line

[illegible]

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Each day in IBD, you'll find these 3 powerful lists all on the same page—giving you a quick snapshot of stocks to keep an eye on.

- *New High List*

Remember what we learned earlier: *Stocks hitting new price highs tend to go higher*. This list shows you which stocks just hit a new 52-week price high that day. Be sure to also read the *New High List Analysis* article right below the list. That gives you more insight into the action of specific stocks.

- *Stocks Just Out of Bases*

Stocks tend to launch a big move by breaking out of a cup-with-handle, double bottom or other type of pattern (Chapter 6). This list highlights stocks that *just* did that. Still, you want to make sure the stock passes the Buying Checklist and is not “extended” beyond the 5% buying range.

If the stock *is* extended, keep an eye on it. It may go on to offer an alternative buying opportunity, like a pullback to the 10-week moving average line, which brings us to . . .

- ***Stocks Pulling Back to 10-Week Line***

As we saw earlier (“Alternative Buy Points,” Chapter 6), after a stock breaks out, it may take a breather and pull back to that benchmark line. If it finds support and bounces higher on *heavy* volume, it could offer a buying opportunity.

When & Where

Daily in the *Making Money* section of IBD

You can also read *New High List Analysis* column on Investors.com

IBD TimeSaver Tables

IBD TimeSaver Tables											
Summary of key price action for NYSE & Nasdaq highest-rated stocks, a quick and easy snapshot for busy investors. <i>Italicized stocks</i> have 80 or higher EPS and Relative Price Strength Ratings and were IPOs in the past 15 years. Sorted by Composite Rating, IBD's single most useful fundamental & technical gauge.											
SMARTSELECT® COMPOSITE RATING EARNINGS PER SHARE RELATIVE PRICE STRENGTH INDUSTRY GROUP RELATIVE STRENGTH SALES+PROFIT MARGINS+ROE ACCUMULATION/DISTRIBUTION						SMARTSELECT® COMPOSITE RATING EARNINGS PER SHARE RELATIVE PRICE STRENGTH INDUSTRY GROUP RELATIVE STRENGTH SALES+PROFIT MARGINS+ROE ACCUMULATION/DISTRIBUTION					
52-wk Stock & High	Symbol	Close	Price	Chg	Vol	52-wk Stock & High	Symbol	Close	Price	Chg	Vol
STOCKS UP						STOCKS DOWN					
99 99 99 A+A B-NH	ThreeDSys	DDD	55.78	+2.43	+66 3.0m	95 99 76 B-A C-81.1	Lululemon	LULU	74.02	-2.21	+67 3.1m
99 99 95 A B-B-NH	LithiaMt	r LAD	39.00	+1.58	+81 507	93 99 81 C-A C-125	LinkedIn	LNKD	112.7	-2.17	+77 2.6m
99 99 89 C-A B-NH	EDTMidstn	EDM	32.40	+1.25	-5 86	91 99 95 C-C B-85.5	WillardOpt	r DDS	81.53	-2.24	+50 839
99 99 77 A-B B-31.7	NeeenahPaper	r NP	30.60	+2.13	+128 160	87 98 77 D A C	91.5WatsonPhar	WPH	84.21	-1.79	+413 4.2m
99 98 95 B-A B	72.9 Commvlt	r CVLT	72.06	+2.40	+9 620	68 91 25 B A C	36.4 MindrayMed	MR	30.17	-2.53	+353 2.0m
99 98 91 A-A A-48.1	Soudastm	SODA	46.84	+1.95	+95 1.9m	28 85 2 E A B-72.5	AbbottLab	ABT	32.05	-33.45	+192 20m
99 98 84 A-A C-NH	Epoch	EPHC	27.92	+0.2	-26 332	20 44 9 D+B B	92.3 DeckersOut	r DECK	38.44	-1.83	+43 3.6m
99 97 96 A-A A-NH	Dorman	DORM	36.57	+1.23	+135 287	10 13 15 D--	B-72.6 PaloAltnNts	PANW	51.23	-2.29	+142 1.4m
99 97 82 A-A B-43.9	NeuStar	NSR	43.68	+1.75	+91 770	.. 52 C--	B-46.4 U.S. Metals	USMI	27.19	-3.88	+20 1
99 96 95 A-B B-NH	Numerex	NMRX	13.79	+0.65	+24 44	.. 37 C--	B 81.4 Pro20yrT	UBT	67.62	-1.91	+370 88
99 96 91 A-B B-43.7	ThorIndust	THO	38.45	+1.02	+4 833	.. 33 C--	C-131 VangExDm	EDV	113.3	-2.69	+254 101

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As the name implies, this list makes it quick and easy to see which top-rated stocks showed bullish action that day. The *TimeSaver Tables* are sorted by Composite Rating (Big Rock #2, Chapter 3) to help you zero in on the true market leaders.

When & Where

Daily in the *Making Money* section of IBD

The New America

THE NEW AMERICA

3D SYSTEMS Rock Hill, South Carolina

A 3D Printer In Your House Might Be The Next Big Thing

BY BRIAN DEAGON
INVESTOR'S BUSINESS DAILY

Twenty-six years ago, Chuck Hull received a patent for a system he called stereolithography.

The patent described a procedure of creating three-dimensional objects with a computer-controlled system that shoots ultraviolet light into a pool of liquid polymer or some other "fluid medium."

The fluid at the surface turns solid when hit by UV light. The object is then lowered as layer upon layer of light beams hit the liquid surface and stitch together, silver by silver, the object the computer has been programmed to produce.

As the Hull patent described, "stereolithography is a method and apparatus for making solid objects by successively 'printing' thin layers of a curable material, one on top of another."

That same year, in 1986, Hull co-founded 3D SystemsSM, now based in Rock Hill, S.C., where he is currently the chief technology officer. It began making and selling expensive 3D printers used in aerospace and automotive manufacturing to develop prototype parts, plodding along in a niche market.

3D Systems

3dsystems.com

Ticker

Share price

12-month sales

5-year profit growth rate

DDD

Near 44

\$322 mil

100%

IBD SmartSelect Corporate Ratings

Composite Rating

Earnings Per Share

Relative Price Strength

Industry Group Rank

Sales+Profit Margins+ROE

Accumulation-Distribution

B

See investors.com for more details

Today, 3D Systems makes a long line of 3D printers ranging in price from \$1,300 desktop printers for the home hobbyist to large \$1 million printers able to make parts for supersonic jets. One of its biggest markets is the health care field, where 3D printers make custom parts for hearing aids, prosthetics and orthodontics, among other items.

Wide Applications

Its 3D printers also make parts for aerospace, military and transportation industries. They can print most anything that can be designed on a computer, from com-



photos and videos into printable 3D objects. And it acquired Rapidform, a provider of 3D scanning and computer aided design and inspection software tools, for \$35 million. Its products are used by engineers and manufacturers.

Asian Presence

Rapidform, based in Seoul, will expand 3D Systems' presence in Korea and Japan. It also has offices in Australia, Italy and the Netherlands. The company has acquired about 30 firms in the last three years, many of them small, extending its platform of capabilities and widening its patent portfolio to more than 1,200.

Since its introduction of stereolithography 26 years ago, 3D Systems has developed other 3D printing technologies for an array of applications. Its printers also use a wide variety of print materials, about 100 of them, that replicate the performance of plastics, metals, waxes, rubbers and other composites.

3D parts can be made in as little as 20 minutes or take more than 40 hours, depending on the complexity. About half its printers currently sold are for manufacturing applica-

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The "N" in CAN SLIM stands for "new"—a new innovative product, new management or new industry trend.

It's a key driver of a stock's climb, as we saw in *Big Rock #2: Focus on companies with big earnings growth and a new, innovative product or service.*

Each day, *The New America* page profiles companies that have that all-important "N."

Be sure to also check out our *New America Analysis* videos, which highlight the latest chart action, ratings and trends of companies recently profiled in *The New America* column.

When & Where

Daily in the A section of IBD and on Investors.com

New America Analysis videos updated weekly under the "IBD TV" tab on Investors.com

IBD Smart NYSE + NASDAQ Tables

IBD Composite Rating Earnings Per Share Growth Rating Relative Price Strength Rating Sales+Profit Margins+ROE Accumulation/Distribution (3 mos)											
52-wk High	Stock Price	Dividend Yield	Close	Vol	Val	Chg	Chg	1000	P	F	F
Common stocks above \$10 for Thursday, January 10, 2013											
1. BUILDING -0.1% Daily +6.95% 1mo											
83 65 77	CA-NH	AAON	1.0	AAON	23.73	+0.45	+62	157	26		
73 44 69	B-B	71.6	AcuityB	.7	AYI	69.51	-0.12	-43	228	23	
86 68 91	DA-NH	AccomTech	r	ACM	27.76	+0.50	+43	1.2m	12		
48 59 26	CC	36.3	AMCOLin	2.6	ACO	30.46	+0.23	+2	125	15	
99 80 98	DA+32.5	AmWdmrk	AMWD	31.60	-0.58	+20	138				
90 75 94	D-B	25.7	ApogeeE	1.5	APOG	24.18	+0.05	-28	139	39	
83 92 47	B-B	19.7	Argann	.0	AGX	17.87	-0.25	-57	58	12	
75 54 73	D-B	56.6	ArmstrW	.0	AWI	54.01	-1.19	+9	318	23	
36 22 45	D-D	20.2	BeazerH	.0	BZH	17.05	+0.07	+29	1.6m		
92 80 80	AA+	17.6	Blount	.0	BLT	17.12	-0.09	-5	265	16	
74 22 96	DA+21.2	BrookfieldRes	BRP	19.63	-0.33	-8	190	31			
33	6 51	E-B	22.3	CRHPC	3.8	CRH	20.73	+0.06	+406	596	20
99 98 97	AA+	17.6	CaesarStne	CSST	20.71	+1.72	+352	219	16		
24 12 16	B-C	54.1	Cavolind	CYCO	46.04	-1.43	-23	32	80		
71 40 82	A-	14.9	CemetsP	1.0	CPAC	13.61	-0.14	-71	927		
77 44 92	E-B	11.2	CemexSab	.0	CX	10.84	+0.08	+43	19m		

IBD Composite Rating Earnings Per Share Growth Rating Relative Price Strength Rating Sales+Profit Margins+ROE Accumulation/Distribution (3 mos)											
52-wk High	Stock Price	Dividend Yield	Close	Vol	Val	Chg	Chg	1000	P	F	F
84 90 53	C-B	47.2	URS	1.9	URS	41.93	+0.44	-20	505	9	
81 48 95	E-B	30.6	USG	USG	28.62	-1.31	+296	5.8m			
88 85 88	B-B	68.4	Valsgar	1.4	rVAL	67.55	+0.35	-37	325	20	
80 64 88	E-B	59.5	VulkanM	.1	VMC	56.22	-0.14	+22	965		
76 69 57	C-B	78.4	Watso	1.3	W50	75.23	+0.55	+11	260	25	
75 52 79	C-B	47.1	WttsWtr	1.0	rWTS	45.67	+0.07	-57	79	21	
89 68 97	CC	20.1	Winnbago	WGO	18.22	-0.06	-17	233	36		

IBD Composite Rating Earnings Per Share Growth Rating Relative Price Strength Rating Sales+Profit Margins+ROE Accumulation/Distribution (3 mos)											
52-wk High	Stock Price	Dividend Yield	Close	Vol	Val	Chg	Chg	1000	P	F	F
66 93 18	AE	14.2	FlyLeas	5.4	FLY	12.69	-0.02	+20	113	3	
95 81 72	A-B	140	FrankRes	.8	BEN	140.6	+0.43	+1	767	15	
70 39 70	C-B	48.8	GATX	2.6	GMT	48.25	+0.03	-4	204	17	
83 79 64	A-B	53.9	GlobPlay	2.1	GPW	49.86	+0.26	-43	402	13	
76 66 44	A-B	16.7	GolubCap	8.0	GBDC	16.05	+0.03	-33	161	14	
37 51 29	B-B	32.5	GreenDotA	GDOT	14.24	-0.09	+4	538	10		
79 28 92	B-A	60.1	Greenhi	3.0	GHL	59.45	+0.62	-38	165	43	
97 80 96	C-A	20.2	HEEqSvs	.0	HEES	19.87	-0.14	-37	127	20	
92 20 94	A-A	18.3	HFF	.0	HF	17.79	-0.10	-40	113	17	
80 89 73	C-B	34.0	HoldPay	.7	rHPY	32.68	+0.06	-2	408	18	
85 56 69	A-B	12.3	HercTcG	7.8	HTGC	12.27	+0.02	-9	271	12	
24 57 10	D-D	18.7	HighOne	ONE	10.59	+0.03	-52	196	14		
96 80 92	A-	22.1	HmlnSv67	HLSS	21.45	+0.09	-64	423	28		
47 58 17	B-B	18.2	HortZec	3.0	HRZN	15.56	+0.11	-60	36	10	
83 80 99	D-B	18.0	ImpactM	IMH	12.40	-0.10	-69	25	8		
31	9 52	B	16.3	InterctB	2.7	IBKR	14.82	+0.02	-49	333	17
86 75 61	AA+NH	IntenlEx	KE	145.2	+1.68	+95	27m	19			
38 75 24	C-B	15.3	Interse	7.8	INTX	10.26	+0.04	-27	40	8	
28 51 11	D-D	27.3	IntlFstone	INTL	17.85	-0.03	-43	24	17		
83 55 72	B-B	28.5	Invesco	2.5	IVZ	27.50	-0.09	+14	11m	15	

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Not all stock tables are created equal.

Most publications either no longer even print stock tables—or just include bare bones data like how much a stock was up or down that day. Most don't even include "volume"—and without volume, you can't tell if institutional investors are heavily buying, heavily selling or just sitting tight.

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- **Volume % Change** for that day: Was it *unusually* heavy or light?
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Symbol	Company Name	EPS Surprise % Chg (Last Qtr) ▼	EPS % Chg (Last Qtr)	EPS % Chg (Prior Qtr)	Sales % Chg (Last Qtr)	EPS Est % Chg (Current Qtr)	EPS Est % Chg (Current Yr)	Tools
CYMI	Cymer Inc	342.9	-14	-66	2	-98	-52	
NFLX	Netflix Inc	200	-80	-89	8	300	293	
AZPN	Aspen Technology Inc	160	117	N/A	16	400	N/A	
BC	Brunswick Corp	125	N/A	28	9	-9	15	
LNKD	LinkedIn Corp Class A	100	267	45	81	58	106	
FNF	Fidelity Natl Finl Inc	90.7	94	49	70	45	78	

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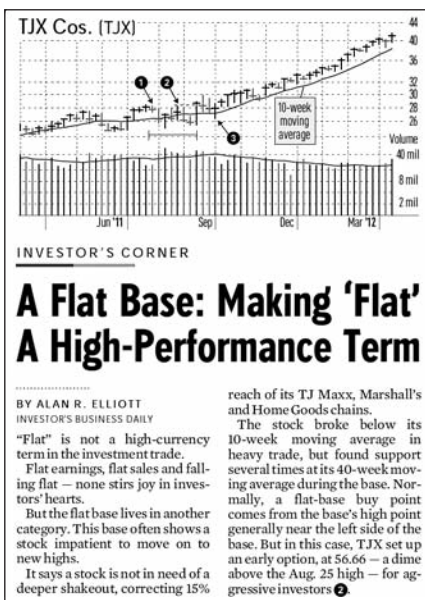
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Reading this column regularly is like having your own personal investing course—which you can take on your own time, at your own pace. It's a great way to enhance and expand on what we cover in this book.

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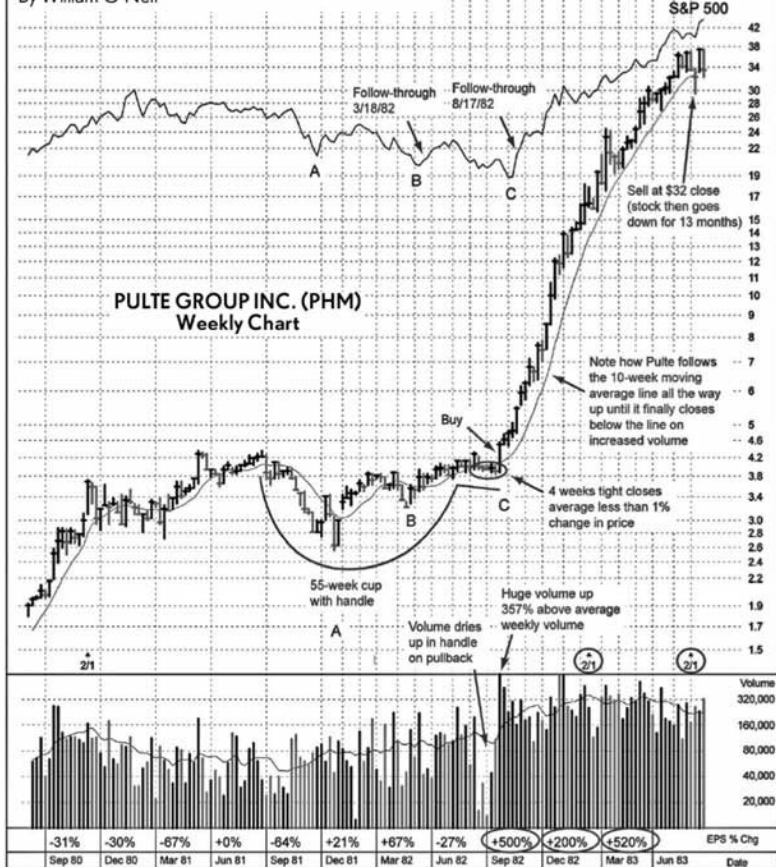
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How to Find & Own America's Greatest Opportunities

A must-read weekly column by IBD founder William J. O'Neil

How To Find & Own America's Greatest Opportunities

By William O'Neil



Before Pulte broke out of its 55-week cup-with-handle base on July 23, 1982, it had increased in price more than 10 times since January 1976. So, Pulte was an outstanding growth stock in the notoriously cyclical homebuilding industry.

It tried to break out after the S&P 500 follow-through on March 18, 1982. However, the S&P rolled over and made a new low that temporarily stopped Pulte's progress. It's very important that you learn to spot and un-

derstand that during a declining general market where the S&P 500 at points A, B, and C makes new lows, Pulte's price at A, B, and C does not make new lows, but holds 20% higher each time. This is a tremendous sign of counterpower, and as soon as the general market finally turns up for real, the stock should be a big leader.

This example also tells you: No. 1 you need to develop your skill at chart reading. No. 2 don't ever get discouraged and stop doing your market homework, and No. 3

once you learn to buy real leaders at the right time, you must have and execute proven sell rules to keep you in for most of the big move up but get you out on the way up to nail down your big gain while you still have it. You don't want to wind up giving it all back.

One rule that works well with many new big leaders is, once you buy right and are ahead, hold until your winner closes for a week clearly below its 10-week-moving-average line in greater than average volume.

By now I think this point is clear: To find *tomorrow's* big winners, you need to know what *past* winners looked like just *before* they made their big price moves. So as part of your search for the next “great story” stocks, be sure to also study past successes.

One of the best ways to do that is to always read Bill's weekly column, where he walks you through the complete “life cycle” of a huge market winner. You'll see:

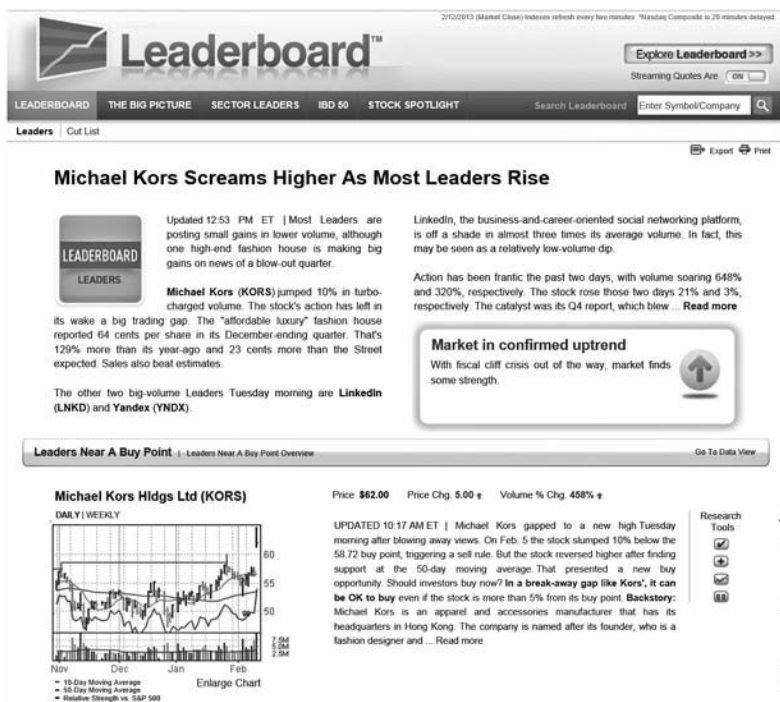
- The explosive earnings growth and other CAN SLIM traits the stock had before it surged
- What innovative product or service was driving that growth
- The type of chart pattern that launched the stock's big move
- Buy, sell and hold signals that showed you the right time to get in—and out

It'll help you spot future winners—and handle them properly and profitably when you do.

When & Where

Wednesdays in the *Making Money* section of IBD

Leaderboard™



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Leaderboard—IBD's premium online service—is another way to find winning stocks before they launch a major price move.

Here's how it works:

- **Leaders List:** The IBD markets team searches for the best-of-the-best stocks and adds them to this small, manageable list.
- **Leaders near a buy point:** Here you'll find alerts to *Leaders List* stocks that are in or near a potential buying range.
- **Intraday chart analysis with buy—and sell—signals:** Typically *before* the breakout, the markets team annotates the charts so you can see the pattern, the exact buy point and any positive or negative signs to keep an eye on. *After* a stock breaks out, the team continues to track the stock, alerting you to any signs that it might be time to lock in your profits.

Because you get ongoing markups and analysis of the charts, I *highly* recommend Leaderboard as a way to learn chart-reading, while also getting alerts to both buy and sell signals in the top-rated stocks.

The Results Are In

Here's just one example of the kind of gains you can tap into using Leaderboard.

Leaderboard Q1 2012 Leaders List Performance

-10%–0	0–10%	11%–20%	Over 20%
Google (–9.3%)	Coinstar (0.2%)	GNC (11.3%)	Tractor Supply (29.1%)
Caterpillar (–7.1%)	Dollar General (1.2%)	VMware (11.4%)	Buffalo Wild Wings (34.3%)
Concho Resources (–2.8%)	Michael Kors (2.0%)	MercadoLibre (11.8%)	Rackspace Hosting (34.4%)
Tangoe (–2.1%)	Autozone (3.7%)	Mastercard (12.8%)	Priceline.com (35.6%)
Transdigm (–1.5%)	Sourcefire (3.7%)	Texas Capital Bancshares (13.1%)	SolarWinds (38.3%)
	UnderArmour (9.8%)	Panera Bread (13.8%)	Invensense (48.5%)
		Celgene (14.7%)	
		Lululemon Athletica (15.0%)	
		Intuitive Surgical (17.0%)	
		Continental Resources (17.2%)	

See How Leaderboard Works—and Take a Free Trial



To watch a video my radio show co-host Amy Smith and I did that shows Leaderboard in action—and to try Leaderboard free for 2 weeks—visit www.investors.com/GettingStartedBook.

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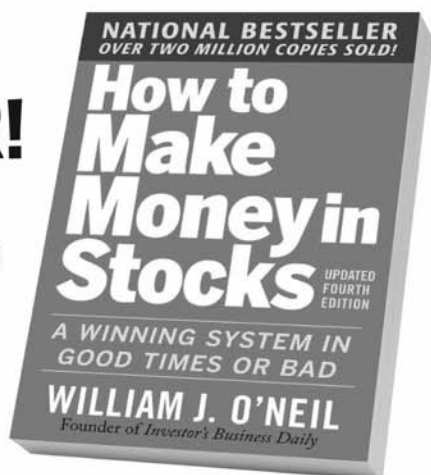
• ABOUT THE AUTHOR •

Matthew Galgani is co-host of the *How to Make Money in Stocks with Investor's Business Daily* radio show, editor of the *IBDextra Newsletter*, and IBD TV® market commentator. Together with IBD chairman and founder, William J. O'Neil, he developed the *IBD Meetup Investor Education Series* used by investing clubs across the country.

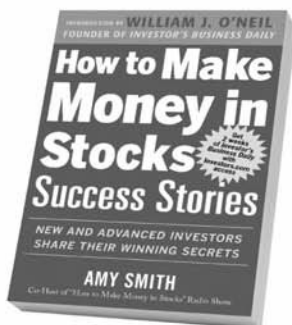
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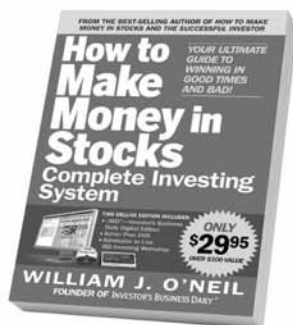
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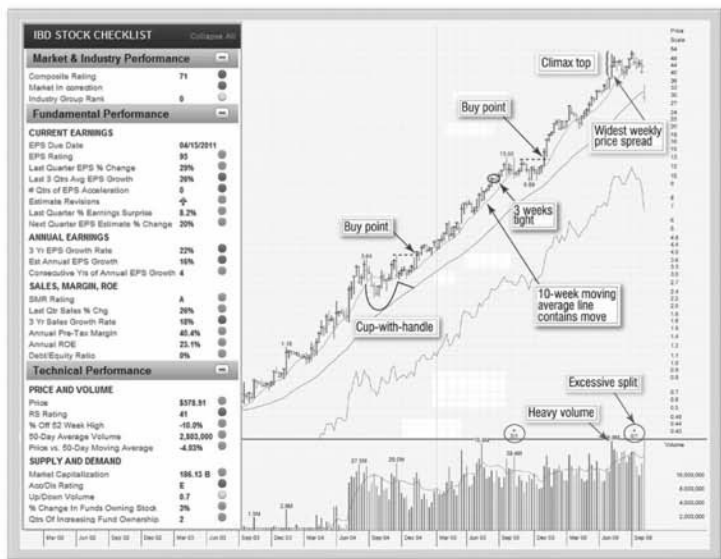
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